Final Report

Innovative financing for homeownership: the potential for shared equity initiatives in Australia

authored by

Simon Pinnegar, Hazel Easthope, Bill Randolph, Peter Williams and Judith Yates

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ACRONYMS

ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
AHIU	Affordable Housing Innovation Unit (SA)
AHURI	Australian Housing and Urban Research Institute
CDO	Collateral Debt Obligations
CML	Council of Mortgage Lenders (UK)
CPI	Consumer Price Index
CRA	Commonwealth Rent Assistance
DCLG	Department for Communities and Local Government (UK)
DFC	Department of Families and Communities (DFC)
DHW	Department of Housing and Works (WA)
DLGH	Department of Local Government and Housing (NT)
EFM	Equity Finance Mortgage
ESRC	The Economic and Social Research Council (UK)
Fannie Mae	Federal National Mortgage Association (US)
FHA	Federal Housing Agency (US)
FHOG	First Home Owners Grant
FOI	Freedom of Information
Freddie Mac	Federal Home Loan Mortgage Corporation (US)
GSE	Government Sponsored Enterprise
H4H	Hope For Homeowners (US)
HMS	Homeowners Mortgage Support
HOLS	Home Opportunity Loans Scheme (HOLS)
HUD	Department of Housing and Urban Development (US)
LGA	Local Government Area
LGD	Loss Given Default
LMI	Lenders Mortgage Insurance
LTV	Loan-To-Value
NAHA	National Affordable Housing Agreement
NBHB	New Build HomeBuy (UK)
NRAS	National Rental Affordability Scheme
NRV	National Research Venture
NSW	New South Wales
NT	Northern Territory
ODPM	Office of the Deputy Prime Minister

OMHB	Open Market HomeBuy (UK)
PD	Probability of Default
RBA	Reserve Bank of Australia
RMBS	Residential Mortgage Backed Securities
ROE	Return On Equity
RTV	Risk Transfer Vehicle
SA	South Australia
SAFA	South Australian Financing Authority
SSD	Statistical Sub-Division
TARP	Troubled Assets Relief Program (US)
TIO	Territory Insurance Office (NT)
UK	United Kingdom
US	United States
VIC	Victoria
WA	Western Australia

EXECUTIVE SUMMARY

In the last few years, shared equity arrangements – where the consumer shares the capital cost of purchasing a home with an equity partner in return for a share of any home price appreciation that occurs – have seen significant growth in Australia. Most states and territories now have schemes operating, although a number remain on a relatively modest scale. More substantive engagement has occurred in jurisdictions where 'government-backed' but arms-length agencies, such as HomeStart in South Australia and Keystart in Western Australia, remain an integral part of local institutional and mortgage finance frameworks. For these organisations, shared equity provision has signified a key innovation within their product portfolios, providing a response to growing housing affordability constraint and a continued commitment to assist lower and moderate income households into homeownership. Alongside government interest, Australia has also been a market leader in terms of unsubsidised, private sector-led shared equity product development.

Research context

This research aims to provide a comprehensive appraisal of the future potential of such arrangements, and the mechanisms required – if appropriate – to move shared equity to scale. In doing so, we seek to:

- increase understanding of the strengths and weaknesses of a range of shared equity models employed both in Australia and overseas from the perspective of consumers;
- identify consumer awareness and assessment of these products alongside institutional and mortgage industry perspectives;
- examine the constraints affecting the viability of shared equity models and the impact on the wider housing system of any widespread adoption; and
- identify the policy, regulatory and funding frameworks required to help underpin the viability and appeal of shared equity arrangements for all parties involved.

The research has been conducted in two stages, with findings from the first stage presented in the Positioning Paper (Pinnegar et al., 2008). This provides a literature and policy review drawing upon Australian and international perspectives on shared equity models. It also reports on interviews with industry and policy stakeholders to ascertain their perspectives, and gauge the level of engagement and product development interest within the sector. We also spoke to a number of existing customers of schemes in Western Australia, Northern Territory and South Australia to gain an insight into their experiences as well as help hone identification of appropriate target groups, shared equity models, and housing market contexts for the second stage of the project.

The focus of this Final Report is on the second stage of the research and the findings from focus group research undertaken with potential shared equity consumers in Sydney, Melbourne and Brisbane in 2008. We then draw these together with our earlier discussions to inform consideration of the appropriate application of shared equity approaches in Australia, and identify desirable roles for federal and state/territory governments within that application. Our assessment and discussion of policy implications focuses on understanding the market conditions and financing frameworks necessary for shared equity to be viable through the market cycle, and, in broad terms, the costs and benefits of government engagement in shared equity schemes.

The financial landscape providing the background and context to this research has dramatically shifted over the past 18 months. When the research was first conceived, it was anticipated that private lenders might play an increasingly prominent role in the provision of shared equity schemes. Despite the arrival of Australia's first unsubsidised product in 2007 (Rismark's Equity Finance Mortgage), interest has remained cautious and the appetite for innovation limited. The impact of the subprime fallout in the US, credit crunch, and global recession on both financial and housing markets has further curtailed activity. It has acted to highlight that assumptions regarding risk sharing and market efficiencies need to be better understood rather than simply accepted.

Looking beyond these challenges, this research takes the position that facilitating both government and lender interests to help deliver household mobility in this transitional space between renting and ownership remains appropriate. Arguably, what *has* changed is that the frameworks necessary to make those partnerships work places the benefits of government involvement on a more equal footing. As a result, a strong focus in the research on the rationale, operation and success or otherwise of current 'government-backed' shared equity initiatives is both a reflection of their role as sites of innovation in recent years as well as recognition of this policy role. How innovation becomes enabled is therefore not simply limited to complex, clever developments in the world of derivatives and securitisation, but balanced by a re-evaluation of the role that sustainable, targeted, socially responsible arrangements operating at the policy-market interface play.

What is shared equity?

Shared equity arrangements cover the range of products, schemes and initiatives which 'enable the division of the value of a dwelling between more than one legal entity' (Whitehead and Yates, 2007, p. 16). This umbrella term is used to encompass government-backed and private sector-led schemes based on arrangements whereby the purchaser enters into an agreement with a partner to share the cost of purchasing a property. The approach is attractive from several perspectives:

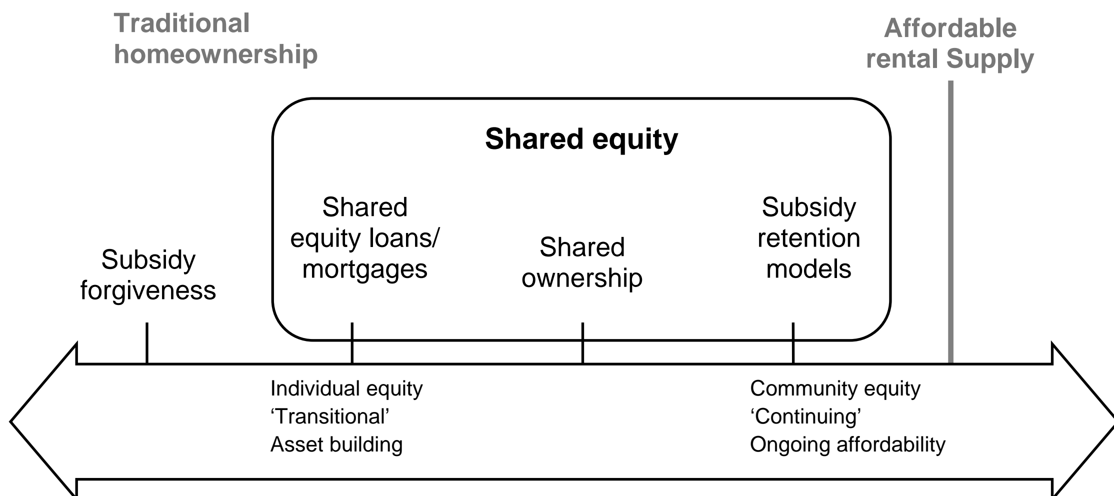
- Compared to conventional mortgage arrangements, shared equity can enhance affordability for homebuyers by reducing both deposit requirements and ongoing housing costs.
- It may provide mortgage lenders with opportunities to expand into new markets and offer equity investors a more flexible opportunity to invest in residential real estate other than through direct investment.
- From a policy perspective, it provides government with the opportunity to develop frameworks that can assist households both access, and sustain, homeownership. More broadly, shared equity approaches can contribute to policy reform and offer a means of leveraging in more – and more appropriate – forms of affordable housing.

Inevitably these benefits have associated risks, and the viability and relative attractiveness of shared equity depends upon favourable financial and housing market contexts. The relatively complex nature of arrangements vis-a-vis standard home loan products emphasises that they cannot be seen simply as a mechanism for addressing barriers at the time of home purchase, but should also reflect the ongoing commitment that these innovative frameworks represent in terms of ensuring that products enable borrowers to sustain ownership, and equally that products provide a viable redemption profile, across the market cycle, to make them 'work'.

Different types of partnership arrangement ensure that shared equity approaches, and how the market views those approaches, take diverse forms. These will reflect, for example, how rights and responsibilities are divided between purchaser and partner; how value in a property is divided and how risk and exposure to equity growth or loss are shared; and whether or not public subsidy is provided, the policy objectives tied to this subsidy, and expectations regarding subsidy preservation or recoupment. Across this range, shared equity is seeking to balance two arguably competing objectives:

- helping consumers gain a foothold on the property ladder and facilitating asset accumulation by the purchaser ('transitional' arrangements);
- protecting affordable homeownership opportunities and preservation of supply (subsidy retention or 'continuing' arrangements).

Figure 1: Positioning shared equity approaches



Source: Adapted from Jacobus and Lubell (2007)

Shared equity schemes currently in place in Australian states and territories primarily fall within the 'transitional' model, and sit firmly towards the left hand side of shared equity approaches identified in Figure 1. Here, arrangements take the form of a loan and comprise a first mortgage taken out by the purchaser on a proportion of the full cost of the property, and a second, subordinate loan (or covenant), set against the remaining portion of that cost. At the time of sale (or refinancing), the partner recoups their equity loan plus a share of capital gains on that share. We have used the term 'individual equity' to describe these arrangements, since gains follow the individual household that initially benefits from the scheme rather than being retained in the property purchased.

We have also been driven by an interest in 'continuing' or 'community equity' models towards the other end of the shared equity umbrella. Here, the partner typically retains a greater proportion of equity, and ongoing interest, in the property. Subsidy is retained and equity gains to individual households limited through the use of predetermined price formulae or indices instead of being based upon open market values. Rather than the initial subsidy dissipating if and when the household moves, the partner's ongoing interest ensures that affordability in that stock is retained for future households.

Research findings and issues arising

Customer views on shared equity

Focus groups were held across a range of lower and moderate value housing markets in Brisbane, Sydney and Melbourne. Rather than trying to extrapolate from participants' views an estimation of the potential scale and nature of a shared equity 'market', our core concern has been to gain a greater depth of understanding in terms of the key aspects shaping shared equity arrangements and how these manifest through both 'individual' and 'community' models. Although its complexity is often perceived as a key barrier, once explained and discussed, people understood shared equity as a concept. They were able to articulate its benefits, recognise its downsides, and accept that trade-offs are inevitably involved. Central to their interest was whether those trade-offs were perceived as reasonable and 'fair', and whether they enabled or precluded attaining their core interest in attaining homeownership.

In consumer terms, both schemes were understood and well received in focus groups. But they represent *quite distinct consumer propositions*. Factors shaping the appeal of the two schemes, and how they might be positioned, are not simply variant forms of the same: they are not interchangeable models to be rolled out in different market contexts. Most participants distinguished between an arrangement they perceived as helping them become a homeowner on the one hand, and an affordable, secure housing option that was a 'good idea, but not for me' on the other.

Individual equity arrangements presented a stepping stone with a route map to *normal, full* ownership. Community equity arrangements, in terms of its characteristics of being tied to particular dwellings and involving a 'not-for-profit', trust or housing association, were perceived by many of our participants as for those whom outright homeownership is an unlikely prospect. Being tied to particular supply and differentiation from the wider housing market reinforces this sense of 'other', and the idea that this was not the housing experience they were seeking to attain through homeownership. Preferring a *helping hand,* rather than an alternative, permanent, intermediate tenure, was a pervasive view of potential consumers across income levels, even where the actual costs of homeownership meant that community equity arrangements were likely to be more feasible for them.

Our findings offer an endorsement of the individual equity initiatives currently in place through arms-length agencies such as HomeStart and Keystart. Participants in our focus groups saw community equity as a means of saving, of building up a deposit, or as an opportunity for stability and security rather than ownership. This is not to dismiss ongoing interest in community equity arrangements as part of the strategic mix at the renting-ownership transition, not least in terms of being able to provide a vehicle for affordable housing supply. But it does perhaps indicate that how these arrangements would be costed, and their policy objectives understood and evaluated, will be on different terms.

Housing market context and shared equity

The research highlights how shared equity initiatives are closely integrated within, and connected to, the housing markets within which they operate. Individual and community equity schemes relate to and depend on, housing market contexts in different ways, and indeed the nature of this relationship acts as a defining characteristic between them.

- Community equity arrangements seek to preserve affordability over time within the stock and, arguably, a distinct sub-market would be established tied to that supply. Although segmented, it would be wrong to suggest that a clear detachment from

wider housing market activity and considerations would exist in this context. If and when customers move home, then issues regarding the interface between scheme and market at the time of exit will impact on options available for mobility in the market

- Individual equity arrangements have a more explicit link to the market context in which they operate. In effect, they seek to work within the parameters of market values and aim to assist households meet those values.

Consideration of issues relating to the interface between shared equity arrangements and the housing market within which they operate should not simply start and end at the point of enabling access and purchase. Arrangements also need to relate to the market context for the duration of the loan. They need to be structured to facilitate and encourage the purchasing of additional equity through 'staircasing', and accommodate the fact that housing markets are dynamic and unpredictable: they are likely to move forward at a steady pace, boom, stagnate and indeed fall over the market cycle.

The design of shared equity initiatives also needs to acknowledge and reflect the spatial differentiation seen within and across markets and submarkets, between and within cities. Such arrangements cannot subscribe to a 'one-size-fits-all' and must be able to respond to the context and dynamics across different geographies. The state/territory-based nature of current government-backed schemes in Australia benefit from a close understanding of local market context and the wider housing system and housing policy arrangements within which they operate. The experience of these schemes points to the need for these organisations to be able to respond on commercial as well as policy terms.

As discussed in the research, schemes have typically allowed customers to purchase within the open market rather than being overtly limited to new supply. The scale of these schemes to date has been small, and at any one time will only account for a contained proportion of overall housing market activity. Unravelling the potential impact of Keystart and HomeStart's shared equity schemes in the Perth and Adelaide housing markets respectively in the past 18 months is difficult. It is possible that some dwelling types and popular first time buyer locations near the price maxima for schemes may have experienced extra demand-side pressures.

Indeed, it would appear that the market has responded proactively, with builders in WA, for example, tailoring their products to reflect the criteria of schemes and marketing the use of First Start as an affordable financing option for the house packages on offer. This is cemented through further innovation led by organisations such as Keystart in conjunction with their respective state housing departments, working with developers to provide frameworks for providing new supply that can be purchased on affordable terms through shared equity arrangements.

A number of recent initiatives – such as VicUrban's Ownhome and Tasmania's HomeShare have been tied more specifically to new supply. There is a balance to be struck. Where schemes can encourage the market to build new supply, then this will bring broader policy gains in addition to assisting target households and groups into homeownership. However, as our research with potential consumers has emphasised, and which leans preferences towards individual over community equity arrangements, products need to provide consumers with the opportunity to behave as much as possible as 'normal' homebuyers. This means being able to exercise choice and having options in terms of location.

Financing shared equity

Alongside consumer and market considerations, the research investigates how shared equity is financed and the financial contexts within which schemes currently operate in Australia and overseas. There are two foci to our discussions.

- Firstly, an overview of the financing arrangements of government-backed agencies is provided, outlining the similar structures within which these schemes operate, but also highlighting differences in terms of governance and flexibilities to act as full commercial concerns
- Secondly, the role of private-sector engagement and leadership in helping build the potential of shared equity is considered, including innovation in the financial markets to foster conducive frameworks for lender, investor and consumer interest.

Inevitably any dichotomy drawn between the two is a false one. Government-backed agencies essentially operate within the market as commercial concerns, interacting with the financial markets much as other lenders do. Similarly, we live in an era where governments are stepping in to rescue banks, guaranteeing deposits, and taking steps to improve liquidity in the system.

Benefiting from guarantees or support agreements which in turn provide access to funding at favourable rate, government-backed agencies have – with hindsight, sensibly – been risk-averse in recent years, tending not to expose themselves to the potential for higher margins (and therefore higher risk). Nevertheless, they operate as commercial concerns, and provide a return on equity albeit at lower rates than expected by investors from the larger banks. Therefore, while subsidy is involved (certainly in the establishment phase), over time such arrangements have demonstrated that they can sustain their lending portfolios, have space to innovate, and indeed can contribute to broader affordable housing funding arrangements while still targeting those households perceived as greater risk by mainstream lenders.

By contrast, private lender interest has been tested by the financial crisis and ensuing global recession. In many regards the challenges facing shared equity financing are similar to those experienced by 'normal' loan and investor considerations. However, both the origins of the current crisis – associated with the promoting of lower income homeownership – and the mechanisms that have encouraged an underestimation and misunderstanding of risk, arguably raise a number of distinct challenges and issues for shared equity. The steep decline in the trading of residential mortgage-backed securities (RMBS) hits complex instruments, second tier/'alternative' lenders, and lending to marginal groups, especially hard.

Of course, shared equity and subprime are quite different things, but the markets' reduced confidence in knowing what has been packaged up, and what those asset classes are now actually really worth, ensures that such assurances are largely circumstantial. Although there are other routes through which private sector-led products can access funds, the appetite for innovation tied to residential lending is likely to be constrained as we move towards a more cautious banking environment in the short term.

Policy considerations

Facilitating, rather than promoting, homeownership

Providing support at the margins of homeownership will always represent a risky arena for housing policy and the market. Although the current financial context and housing market response in many countries has pulled optimistic assumptions about

the benefits of ownership into sharp relief, it is unlikely to signal a retreat from continued support and commitment to making the tenure accessible to those who aspire to, and can sustain, homeownership. However, a more balanced understanding of the risks involved, and the limitations of the private sector to effectively manage and price those risks is sensible.

An important distinction can be drawn between ideological promotion of increased homeownership rates on the one hand and a role for government in *facilitating* ownership in a targeted way to address barriers to mobility on the other. Rationale for the latter can be supported given that;

- even if markets were to be more efficient, equitable and more reliable in terms of tracking a sustainable trajectory, there will always be a tranche of aspirant, as well as existing, homeowners who straddle this part of the housing continuum and who legitimately the state may wish to assist;
- the housing market in itself is unlikely to resolve continued challenges around this nexus. Thus, even if (when) much of potential overpricing in the market unwinds, there is a continuing policy role to be played in providing opportunities for mobility, ongoing support, and preventing the risk of falling out of ownership.

Indeed, it can be argued that the case for policy engagement, and responsibility, at the government-market interface has been strengthened rather than weakened by these events and the value of that involvement as ongoing rather than a one-off, and having relevance across market cycles, underscored.

Is shared equity an appropriate response in this complex policy space?

Shared equity is one response. It is not a straightforward arrangement, and introduces a degree of complexity for all parties involved. It requires administrative frameworks, regulatory structures and support mechanisms to be in place that can respond and evolve over time across a range of policy and market contexts. In the context of community equity schemes, it will also necessitate capacity building and development of a housing association sector or equivalent, to act as partner with long-term ongoing interest in an affordable housing portfolio. Facilitating access to homeownership at a point in the market cycle where housing can be considered relatively overvalued is clearly not sensible, and frameworks need to ensure that such tools operate with the necessary commercial acumen to protect the interests of all parties involved. The limited success to date in encouraging private lender engagement also reflects the complexities and degree of unknown risk involved. Partnership working with government can help ameliorate some of these risks, but nonetheless the actual need for, and existence of, such partnerships in itself acts to reinforce that complexity.

Despite this caution, it is argued that shared equity schemes can play an important role in helping to assist household mobility at the margins of ownership. Justification for policy engagement in these complex arrangements vis-à-vis other methods revolves around the very fact that the margins between renting and ownership for certain household groups require ongoing rather than one-off support to ensure sustainable outcomes.

Justifying government interest in cost/benefit terms

This research did not set out to detail the tangible and intangible housing and non-housing related benefits that may or may not arise from assisting households into homeownership. Given the breadth of policy considerations across which shared equity conceivably sits, assessing its relative effectiveness or efficiency against other policy goals and the best alternative use of any subsidy involved is likely to get lost through complexity. The costs and benefits involved stretch far beyond the balance

sheet of a simple transaction, and will be shaped by the governance structures and policy-market interface of the administering organisations, the scale and nature of the programs involved, and the tax and benefit regimes within which they sit. We also remain at the early stages in terms of understanding the actual level of subsidy involved given the trajectory and redemption profile of loans remains.

In the context of government-backed agencies, as profitable enterprises working to an agreed return on equity, the need for such subsidies would seem to be largely obviated. However, subsidy *is* involved, particularly in the early stages when the costs of covering those loans have to be accounted for (and thus negotiate prevailing budget constraints), regardless that repayment and redemptions will provide returns that cover those initial subsidy costs, the servicing of that subsidy and indeed profit over time. Consideration also needs to be given to vertical equity and 'middle class welfare' concerns.

Even if subsidy, and the risks to government tied to provision of that support, can be justified, how do we understand the benefits? Our study consolidates previous cost/benefit considerations focused on the transaction between government and borrower, and how that transaction can be justified (or not). While these parameters remain relevant, shared equity arguably only demonstrates its merits compared to simpler transactions such as the First Home Owners Grant where the case is made for a more strategic take on its broader contribution to housing policy objectives. In this regard, shared equity arrangements need to be framed to:

- signify broader strategic intent and contributes to the delivery of 'whole-of-housing-system' policy;
- offer a means of assisting mobility and addressing affordability constraints between renting and ownership in a targeted, sustainable way;
- represent a strategic framework rather than a reactive response for assisting households at risk of falling out of homeownership;
- where tied to new supply, stimulate the provision of more, and more appropriate, forms of affordable housing;
- provide an integral component within wider housing and urban renewal objectives, for example movement towards mixed communities.

Who should be assisted: low or moderate income households?

Shared equity arrangements need to balance commercial sensibilities with social policy objectives in order to be viable. As housing market values change, interest rates move up and down, refinancing rates and lender competition make initiatives relatively more or less attractive, then the customer profiles for shared equity schemes will (and should) change over time. Recognising this shifting customer base is crucial, as is ensuring that organisations can respond effectively in commercial terms to these changing contexts. Therefore, issues for policy relate less to overly constrained eligibility criteria tied to meeting specific policy goals – for example, helping social housing tenants into homeownership – and more to ensuring flexibility for organisations to both respond to the market and act responsibly as determined by those market conditions.

Current initiatives provided by government-backed agencies, with eligibility criteria encompassing moderate as well lower income groups, can be seen as appropriate in terms of reach. It means not only that those organisations are able to sensibly respond in times of significant affordability constraint, but also ensures a more rounded customer profile helping mitigate against being exposed to the risks inherent

in any overly narrow focus. If policy is seeking to facilitate ownership – as here – then it needs to work with the market.

Realising the potential for shared equity arrangements

The future potential for shared equity arrangements has often been considered from an assumption that it is a question of getting the product right and removing barriers to the realisation of what should be, on paper at least, a 'win-win' situation. For government, this has meant looking at ways in which the private sector can be encouraged to play a greater role, and identifying ways in which long-term funds (such as institutional funds, superannuation) can be married to long-term debt. In the current financial context, a degree of reappraisal is inevitable. Expectations that the private sector can be encouraged to take on the additional risks (real and perceived) tied to innovative finance products will be subdued in the short-term.

However, bringing together public and private sector interests in sharing the risk-return balance continues to be an appropriate goal. Recent events remind us that this partnership is both necessary as well as beneficial, reiterating the valuable role that government-backed arrangements play in providing a sustainable framework for affordable finance through market cycles. The report argues that longer term partnership goals may be framed in terms of promoting mechanisms that:

- Acknowledge the existing strengths provided by government-backed arms-length agencies (where they operate), offering products that act as a sustainable 'stepping stone' to mainstream housing finance as well as necessary safety nets.
- Enable the more effective interplay between government and the wider mortgage industry where strengths on each side are equally acknowledged.
- Avoid additional levels of complexity wherever feasible. While shared equity should not be treated as something that can be overly simplified, schemes should seek to reflect 'normal' operations and expectations as much as possible.

In broader policy terms, it is not only about recognising that a continuum of strategies and approaches are required when taking a 'whole-of-housing-system' approach, but starts to understand how public and private sector arrangements can best work together to *deliver* those strategies.

Acknowledge strengths of existing government-backed, arms-length agencies

We should take significant heart that the approach taken by these agencies in recent years has – when compared to the big scheme of things – been largely right, rather than largely wrong. As such, these organisations can provide a strong basis upon which greater synergies between the public and private sector can be built:

- Sound social, ethical and business objectives – tied to long standing state level relationships with government departments, lenders and development industries, and indeed their local customer base – have fostered a basis for trust and demonstrated the role they play in wider policy contexts.
- Although operating as commercial concerns, they have done so under the watchful eye of their respective Treasuries. Agencies benefit from not being subject to investor expectations on return on equity, but nonetheless operate with the same financial rigour. Equally, some distance from the direct policy line is crucial. If too close, competing funding priorities and demands are likely to come into play.
- Given their state/territory based remit, they are able to recognise and respond to housing markets that exhibit significant spatial and temporal variation, and have

had to operate within housing markets without risking becoming a victim of, or simply fuelling, overheated prices.

These agencies can be seen to provide a transitional helping hand with safety nets for those for whom the transition requires more ongoing support. Holding onto good customers is sound business practice, but positive policy outcomes can also be measured in terms of the rate at which loans are discharged and customers move into 'prime' arrangements with mainstream banks. If schemes are structured to encourage mobility and flexibility to 'staircase', 'step up' their equity shares (and, if necessary, 'step down') they are likely to work better for *all* stakeholders involved.

Continue to encourage synergies between government and private lenders

While the benefits of agencies such as HomeStart can be acknowledged, this should not preclude consideration as to how their operations may be further assisted, or greater leverage achieved, through encouraging synergies with private lenders and investors. In general terms, this may involve sharing information to build up a better understanding of product behaviour, risks and redemption profiles. It may also involve closer co-ordination at the time of establishing equity loan positions or, once a portfolio has been established, ensuring frameworks that offer an efficient means of selling down those assets.

Over time, such arrangements can be seen as a means for integrating shared equity provision into mainstream lender activity. This has the advantage of reducing or avoiding debt held on government books and the risk attached to this, and is likely to encourage conditions where the potential for shared equity arrangements to act as a stepping stone are maximised. However, there is a risk that many of the underlying success factors of current frameworks would not be replicated, most importantly, the basis for socially responsible practice and on-going support which accompanies the holding of debt. A second strength of continued close government engagement that may be lost in such trade-offs is tied to the value such organisations can play in terms of helping drive innovation in affordable housing provision more widely.

Acknowledge complexity, but avoid further complications

The complexities involved in shared equity provision should not be dismissed, and indeed underpin much of the rationale for governments' responsibility in engagement in such arrangements. However, there is clearly a good case not to further add to those complexities wherever feasible.

Existing initiatives essentially aim to reflect conditions and experiences within the open market and do so by seeking to 'normalise' the nature and condition of the products as much as possible. Individual equity arrangements are more complex than a standard home loan and disrupt the traditional relationship between lender and borrower. However, they are arguably less so than seen with community equity arrangements, where administrative, legal and valuation considerations reflect added degrees of variation from understood practice. Seeking to foster arrangements that work, where possible, within existing structures is not to argue against innovation and the development of more sophisticated products, but as our research with potential consumers echoe, in the short term at least, products enabling the prospect of full, 'normal' ownership over time provide the more realistic potential.

Addressing a currently fragmented policy landscape

Most states and territories without an arms-length agency *are* moving forward with initiatives, although these have tended to be on a smaller scale and, being administered by housing departments, are foremost 'policy led' rather than operated through a balance of commercial and social objectives. These arrangements should

certainly not be dismissed, and in the case of Tasmania's HomeShare offer useful insights into partnership working with a mainstream lender. However, they are unlikely to evolve to replicate the scale seen in South Australia or Western Australia without further support. If it is appropriate that such arrangements should be made available to target groups whether they live in Sydney, Perth or Brisbane – and a case can be made that would support fairness in terms of access across the nation – the core policy question arising focuses upon how that can be achieved.

Endorsing existing and re-establishing state and territory schemes

One policy response would be to support existing state and territory level agencies and promote the re-establishment of arms-length agencies in jurisdictions where such arrangements have lapsed. The success of organisations such as HomeStart has been built on establishing and consolidating their role within the policy, market and lending contexts in which they operate, building trust, and demonstrating their remit over time. This research has made a strong case for the value provided through engagement at this spatial scale, enabling local market responsiveness and institutional context to be recognised.

A NSW or Victoria equivalent of HomeStart cannot be established overnight. It would be a bold and dramatic shift for governments in those states that suffered from the fall-out of the low-start loans saga in the early 1990s to return to such models. The level of commitment required to re-establish those frameworks is substantial. Nevertheless, acknowledging those difficulties should not instantly close down debate. There should be few regulatory impediments for agencies to be built up again in those jurisdictions where they have lapsed. The primary challenges are political and financial.

Justification of advocating this reinvestment and commitment extends beyond simply providing a vehicle for administering shared equity products, to thinking about it in terms of re-establishing frameworks that can help drive innovation in terms of assisting access and sustaining homeownership across a range of policy options. The ability to deliver more effective, integrated, 'whole-of-housing-system' policy requires commensurate financing vehicles that can assist in the translation and delivery of those strategies. As has been seen in South Australia, advances in affordable housing policy have been assisted by the opportunities presented by HomeStart's capacity to drive forward innovative financing arrangements.

Although this option clearly places a spotlight on the states, close co-operation with and leadership from the Federal Government will be vital in terms of sharing initial risks and ensuring that policy frameworks at all levels of government are coordinated.

A 'national' shared equity scheme?

Alternatively, national reach could be fostered through a new scheme overseen and administered from Canberra. This would represent an equally substantive commitment. It would risk replication with initiatives already in place, and would need to establish frameworks that ensured that variations in market dynamics, affordability and consumer interest across the country could be accommodated. The strengths of state/territory based schemes would be hard to create: it is unlikely that the sensitivities required in terms of understanding local needs, responsiveness to market dynamics and integration with wider housing (and indeed social and economic) policy objectives could be fostered through delivery at this scale.

Rather than starting from scratch, the potential to extend the operations of existing organisations to states where shared equity arrangements are not available could be explored. How such arrangements relate back to the policy line, to Treasuries in terms

of guarantee provision, shouldering risk, and flow back of any profits raise important questions. For the existing agencies themselves, there are concerns tied to such expansion, not least in terms of their ability to replicate key success factors at this scale.

Engagement at all levels of government

While a nationally *administered* shared equity scheme is not advocated, this does not preclude the important role for more structured Federal commitment. Indeed, clarification of support is required, and may be provided, on a number of levels.

- → Identifying the contributory role appropriately targeted schemes can play in helping deliver the aims and objectives of the National Affordable Housing Agreement (NAHA).
- → Demonstrating a long-term commitment to shared equity arrangements. That commitment needs to demonstrate involvement over market cycles, and the different conditions and challenges that operating over a cycle involves. In this regard, it is not only about identifying shared equity as a means of assisting access to ownership, but also a mechanism providing ongoing sustainability and affordability.
- → Fostering an environment that balances nationwide consistency and certainty in terms of taxation, reporting and regulatory arrangements on the one hand, and helps to build and support local market responsiveness and flexibility on the other.
- → Fostering transparency and sharing of information – *between governments, private lenders, and investors* – as schemes gain insight from redemption profiles, rates of staircasing, and flows of assets and liabilities in order to better understand the nature of shared equity products.

One route might explore an umbrella 'guarantee' or support agreement under which different arrangements (existing government-backed agencies, newly established, not-for-profit, or indeed private lender-led) can be accommodated. If a case is made for underpinning support for state/territory based arrangements, then a key role for the Federal Government may relate to helping share the risk, and mitigating institutional caution, in re-establishing such agencies in states. This may involve provision of supportive frameworks between federal and state Treasuries in the establishment phase of new agencies until they reach scale and establish their own momentum.

A national framework in support of financing arrangements would also help provide scale, help spread location risk across different housing markets, and enhance the cost effectiveness of shared equity products. This could include the provision of a secondary market function with the Federal government buying in state/territory equity loan assets and acting as a conduit to achieve greater certainty before selling them down to investors in the wider market. Such a vehicle might make it easier for those jurisdictions currently not active to engage with a shared equity program. As well as 'top down' commitment, coordination between all levels of government – including local government – to address legislative or institutional barriers to sound innovative practice is required.

The potential for shared equity arrangements in Australia

Shared equity arrangements should not be regarded as the panacea for addressing all housing affordability constraints faced by lower and moderate income households. Such arrangements are complex, demand long-term policy commitment, and if utilised in a focused, effective way, should actually mean that moving to a significantly larger scale is unlikely. *It is argued here that this is appropriate*. Rather than seeking to determine and respond to the potential demand within the market, shared equity

should be seen as one component within a range of policy responses at this point in the housing continuum.

Where appropriately targeted, shared equity arrangements can transform people's lives for relatively little or no subsidy in the long-term. However, the parameters for schemes to ensure that their value as a stepping stone are maximised are tight. These constraints need to be balanced by sufficient scale to make products a viable prospect over the market cycle. Scale is also required to provide confidence, demonstrate track-record, and underpin wider market and investment interest. The new National Affordable Housing Agreement (NAHA) will frame ongoing discussions regarding government engagement and potential support for shared equity schemes. In the context of this agreement, such initiatives not only represent an important contribution to assisting affordable, sustainable access among key target groups, but also one that can reflect and capture commitment towards promoting the role of housing in wellbeing, and extending the housing reform agenda beyond the traditional focus on social housing provision and private rental assistance.

1 INTRODUCTION

This report is the final output of an AHURI-funded research project, which aims to provide a comprehensive appraisal of the appropriateness and potential for shared equity approaches to assist Australian lower and moderate income households into affordable and sustainable home ownership.

1.1 Background

The past decade has witnessed a growing level of concern over the affordability of Australian housing. This concern has been manifest in escalating property values especially, but not exclusively, in the capital cities. A growing gap between house prices and household capacity to pay (as measured by household incomes) has been one of the biggest threats to the performance of the national economy over this time (Berry, 2006). While the average Australian home cost four times the average Australian household annual income in 1996, this had risen to seven times in 2006 (ALP, 2007). Moreover, this decline in affordability generally has been accompanied by increasingly limited alternative housing options for lower-income working households.

In response to this concern, most states and territories have introduced shared equity initiatives, inter alia, to assist lower-income households in purchasing their first home. For some jurisdictions, this reflects product innovation within the established product portfolios of government-backed (but 'arms-length') agencies such as HomeStart in South Australia and Keystart in Western Australia. In states and territories without these organisations, initiatives have been smaller in scale with respective Housing Departments typically taking the lead. Alongside these policy-directed initiatives, private sector lender interest has also emerged, although as the global financial crisis has taken hold this has – at least in the short term – become rather muted.

The essential feature of shared equity models is that the consumer shares the capital cost of purchasing a home with an equity partner, thereby permitting households to buy a home with lower income levels than would be required otherwise. The approach is attractive from several perspectives (Whitehead and Yates, 2007). Compared to conventional mortgage arrangements, shared equity can enhance affordability for home buyers by reducing both deposit requirements and ongoing housing costs. It may provide mortgage and investment industries with opportunities to expand into new markets. It may also provide equity investors with a more flexible opportunity to invest in residential real estate than through direct investment.

From a policy perspective, it provides government with the opportunity to develop frameworks that can assist households both access, and sustain, homeownership. This may help relieve the strain on already limited assisted housing programs, and facilitating ownership of property assets among lower income households may reduce reliance on welfare in later life. More broadly, shared equity approaches can provide a framework to modernise government commitments to social and affordable housing provision and retention, and offer a means of levering in more – and more appropriate – forms of affordable housing.

Inevitably, these benefits have associated risks, and the viability and attractiveness of shared equity will also depend upon favourable financial and housing market contexts. Much of the attraction of shared equity for potential customers, lenders, investors and governments lies in an assumption of longer-term residential property asset growth at least in line with general inflation, as well as a more or less benign economic and fiscal regime. Such conditions arguably help policy-makers stimulate household mobility in this transitional space between renting and ownership with limited subsidy

costs over the long term. They also provide a greater degree of certainty and an environment conducive for the financial innovation sought by lenders and investors.

However the impacts of the subprime fallout in the US, credit crunch, and ensuing global recession on both the financial and housing markets act as a reminder that assumptions underpinning policy can quickly, and deeply, unravel. The risks tied to an overreliance of economies on housing consumption and asset-based welfare regimes become exposed, and the role of governments in promoting homeownership amongst lower-income groups questioned. Shared equity risks being wrapped up within these difficulties, seen as a complex instrument and an example of policy engagement at the margins of the market.

Looking beyond these challenges, this research takes the position that assisting both public and private interests to help deliver household mobility in this transitional space between renting and ownership remains important. What arguably has changed is that the frameworks necessary to make those partnerships work places the benefits of government involvement on a more equal footing. As such, innovation is not simply the preserve of complex, clever developments in the financial world of derivatives and securitisation, but balanced by a re-evaluation of the role that more cautious, sustainable and targeted frameworks operating at the policy-market interface play.

Moving forward, the National Affordable Housing Agreement (NAHA), which began operation in January 2009, will frame ongoing discussions regarding government engagement and potential support for shared equity schemes. In the context of this agreement, such initiatives not only represent an important framework that contribute to addressing housing affordability constraint among key target groups, but also one that can reflect and capture commitment towards promoting the role of housing in wellbeing, and extending the housing reform agenda beyond the traditional focus on social housing provision and private rental assistance. As such, shared equity can be positioned as an integral component of a 'whole-of-housing-system' policy approach.

1.2 Research objectives

This project has a number of interrelated objectives. From the outset, the challenging task of addressing the varied requirements, preferences and barriers faced by potential customers, lenders and investors – as much as simply meeting government policy aims tied to shared equity arrangements – was recognised. There is little value in advocating products that perform admirably against certain criteria but are limited severely against others. Products that excel in terms of investor requirements will not succeed if unpopular with potential customers, and vice versa. In order to reflect this, the research incorporates perspectives from the wide range of stakeholders involved, and provides a framework that takes into account broader policy implications associated with the introduction of shared equity initiatives.

The research aims to:

→ Increase understanding of the strengths and weaknesses of a range of shared equity models employed both in Australia and overseas from the perspective of consumers.

→ Identify awareness and assessment of these products alongside institutional and mortgage industry perspectives.

→ Examine the constraints affecting the viability of shared equity models and the impact on the wider housing system of any widespread adoption.

→ Identify the policy, regulatory and funding frameworks required.

The research focuses on what we have termed policy-directed or 'government-backed' initiatives. This focus does not obviate the importance of having financing and market structures that will enable the successful development of all shared equity products. It also does not presume that policy-directed initiatives will be administered by government. However, it does indicate our interest in a targeted approach that is likely to be supported by public subsidy.

Thus our core interest is in arrangements that:

- Facilitate access to homeownership for target groups, defined by policy objectives.
- Are financially sustainable over the long term for the target groups for whom they are intended and promote mobility of those households by assisting in asset-building and wealth creation.
- Reflect consideration of a range of possible solutions based upon the distribution of risk and benefit to government, purchasers, finance providers and investors.
- Reflect consideration of a range of possible solutions based upon different funding models and modes of stimulating new supply and preserving existing housing.

Given that shared equity arrangements are typically predicated on providing access to homeownership for households facing barriers due to affordability constraint, this research clearly sits within two quite pivotal, housing debates.

The first relates to the drivers, patterns and explanations for housing affordability constraint experienced in many advanced economies in recent years. Both AHURI National Research Venture (NRV) 2 (21st Housing Careers) (Beer et al., 2006; Beer and Faulkner, 2009) and NRV3 (Housing Affordability for Lower Income Australians) (Berry, 2006; Milligan et al. 2007; Yates and Milligan, 2007) have provided rich debate. Central to how policy and markets might respond is the extent to which decline rates of access to ownership reflect behavioural patterns or reflect changing 'housing careers' and the degree to which declining affordability for increasing numbers of lower income households is a structural rather than cyclical problem.

The second debate relates to the question of promoting and encouraging access to homeownership. Similarly here, there is a long research and policy tradition that articulates the potential benefits as well as risks of helping lower-income, more marginal and otherwise excluded groups into the tenure. For a discussion of the benefits, see Baum and Wulff (2001; 2002); Bridge et al. (2003); Merlo and Macdonald (2002). Risks are considered by Davis (2006), Kemeny, (1981), Shlay (2006) and Troy (1996). Current research is also underway at the AHURI Swinburne-Monash Centre (investigating to what extent the benefits and risks of homeownership are experienced differentially by lower income households compared to those in higher income groups (Hulse and Burke, 2009) .

It is not our intention to extensively re-rehearse these debates in this report, although they clearly infuse discussion throughout. We have taken as a starting point the recognition that homeownership and aspirations towards being a homeowner are key characteristics of most housing systems, rather than making judgements about the superiority or inferiority of different tenure classes. Nevertheless, recent turmoil in international financial and housing markets has spliced these debates together and forced them firmly centre stage. Our research findings support the policy rationale for engagement in this transitional space within the housing continuum. Policy interest should exist, because the space between renting and prime lending will always exist and, regardless of prevailing market contexts, there will also be groups on the 'cusp of affordability' (Williams and Bennett, 2004) and marginal owners at risk of falling out of homeownership. In this regard, shared equity is not seen as a vehicle for promoting

one tenure or another, but rather a targeted, responsible framework that may be appropriate to, and beneficial within, a 'whole of housing system' strategic approach. Distinctions between promoting and facilitating homeownership are returned to in the concluding chapter.

1.3 Research approach

The original proposal outlined four research components. Refinement of research design meant that talking with 'existing and potential consumers' was split, reflecting a desire to stage the research and prepare a report covering early findings in 2007. As a result, a revised approach comprised six elements across two stages.

Stage One involved:

- Compiling a literature/policy review drawing upon Australian and international perspectives on shared equity models.
- Talking to existing customers of shared equity products/schemes.
- Talking to industry and policy stakeholders to ascertain their perspectives on shared equity schemes and gauge the level of engagement and product development interest within the sector.
- Identifying appropriate target groups, shared equity models, and potential markets for exploration with potential customers.

Stage Two involved:

- Establishing focus groups to explore potential customer perspectives, interests and questions arising from consideration of two shared equity models.
- Assessing the viability of different models given different market contexts and identifying the policy, regulatory and funding frameworks needed if shared equity arrangements were to be adopted, if appropriate, more widely.

Findings from Stage One have been presented in the Positioning Paper for this project (Pinnegar et al., 2008), and it not intended to rework the detail of these discussions within this Final Report. However a brief reminder of key definitions used in relation to shared equity arrangements is provided in section 1.4, and an overview of current state and territory based initiatives provided in 1.5. Short summaries of the key findings and issues arising from our first stage interviews with existing customers, lenders and institutional stakeholders are presented in section 1.6.

The focus of this Final Report is on the findings from focus group research undertaken with potential shared equity consumers in Sydney, Melbourne and Brisbane in 2008. We then draw these together with our earlier discussions to inform consideration of the appropriate application of shared equity approaches in Australia, and identify desirable roles for federal and state/territory governments within that application. Our assessment and discussion of policy implications focuses on understanding the market conditions and financing frameworks necessary for shared equity to be viable through the market cycle, and, in broad terms, the costs and benefits of government interest and engagement in shared equity schemes.

1.4 What are shared equity arrangements?

Shared equity as used in this research covers the range of products, schemes and initiatives which 'enable the division of the value of a dwelling between more than one legal entity' (Whitehead and Yates, 2007, p. 16). This umbrella term is used to encompass government-backed- and private sector-led, subsidised and unsubsidised, schemes which are based on an arrangement whereby the purchaser enters into an

agreement with a partner to share the cost of purchasing a property. The term is also often used as quick shorthand without careful examination of a range of important embedded issues, which we aim to tease out through this research.

Distinguishing features between schemes can be considered in terms of factors that shape these partnership arrangements, for example:

- How rights and responsibilities are divided between the purchaser and partner.
- How value in a property is divided between the purchaser and partner. Partnership may take one of many forms, with different models shaped by how both risk and exposure to equity growth or loss are shared.
- Whether public subsidy is provided, the policy objectives tied to this subsidy, and expectations regarding subsidy preservation or recoupment.

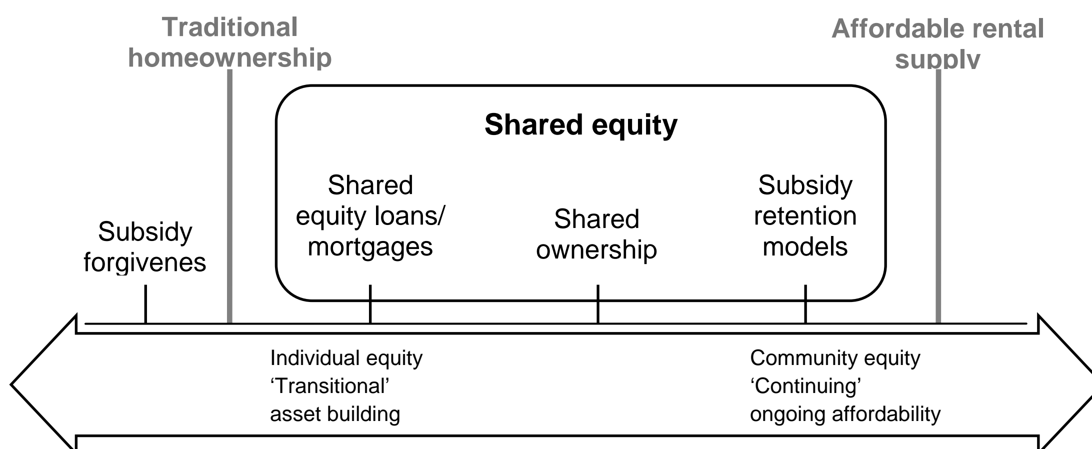
Different partnership arrangements ensure that shared equity approaches, and how the market views those approaches, take diverse forms. This can be conceived as a continuum of approaches that seeks to balance two arguably competing objectives (Jacobus and Lubell, 2007; Whitehead and Yates, 2005):

- Helping consumers gain a foothold on the property ladder and facilitating asset accumulation by the purchaser ('transitional' arrangements).
- Protecting affordable homeownership opportunities and preservation of supply ('continuing arrangements').

While the first objective aligns with current policy-directed, government-backed schemes in Australia, for this research we have explored the potential application of models that relate and contribute to both aims. We see consideration of the second objective as key to the question of sustainability over the long term and a necessary adjunct to the first that focuses primarily on access issues. Figure 2 adapts Jacobus and Lubell's continuum of housing strategies[1] to indicate where different subsidised shared equity arrangements can be positioned. As a means of teasing out broad approaches, three types are identified:

- Shared equity loans/mortgages.
- Shared ownership.
- Subsidy retention models.

Figure 2: Positioning shared equity approaches



Source: Adapted from Jacobus and Lubell (2007)

[1] Which in turn draws upon the typologies developed by Davis, 2006

1.4.1 Shared equity loans/mortgages

Shared equity loan arrangements are *typically*, but not always, in the form of mortgages. They comprise a first mortgage taken out by the purchaser on a proportion of the full cost of the property, and a second, subordinate loan, set against the remaining portion of that cost. Sometimes the secondary 'loan' may take the form of a covenant deed (as is the case in Western Australia's Keystart First Start loan). Either way, this second element, held by the partner, represents an equity share in the property for the loan period, which is recouped alongside a share in capital appreciation at the time of sale. Determination of return on the equity share is dependent on the nature of the contract. There is an expectation that purchasers will buy further equity tranches and progress to full ownership over time.

Equity loans have been the predominant approach in Australia to date. They typically promote individual asset gain and provide less opportunity for protecting affordability over time than subsidy retention models, since any benefits of appreciation are extracted by the borrower and the lender.

1.4.2 Shared ownership

The terms 'shared equity' and 'shared ownership' are sometimes used interchangeably (see Whitehead and Yates, 2007)[2]. A number of distinguishing characteristics can be identified, however. Firstly, shared ownership purchasers typically make repayments on the mortgage component, but pay rent on the remaining portion3. Secondly, the partner has a stronger ongoing interest in the property, particularly at the time of selling on. As with shared equity schemes, shared ownership traditionally has enabled primary owners to 'staircase'4 their equity share in tranches to outright ownership when they wished to, at a price based on market values at that time. However, partners take a greater interest in the property at the time of sale, for example in agreeing on the sale value, in having first right of refusal on buying the purchaser's share, and in determining the conditions of on-sale to any identified target groups.

1.4.3 Subsidy retention models

Shared equity mortgages (and to a lesser extent, shared ownership) offer approaches largely predicated on market growth as a means of assisting asset building by individual households. Although public subsidy will be recouped by the provider at the time of loan discharge – market conditions willing – gains can be seen to accrue disproportionately to the purchaser at the expense of recouping a 'fairer share' given that initial subsidy to help preserve ongoing affordability or what can be called 'community equity'. While subsidy retention models are based in principles of equity sharing, they are predicated on the 'community's' share of the equity staying with the actual home, which acts to reduce the cost to the next buyer (Jacobus and Lubell, 2007). Subsidy is retained by limiting the ability to sell properties on the 'open market', for example through applying pricing formulas. Such arrangements offer opportunities to provide and target new supply at households with lower incomes than would be

[2] While not necessarily the case in Australia, the terms are used to distinguish between different models in other countries, particularly in the UK.

[3] The amount of rent paid under such arrangements is comparable to payments made on interest-bearing equity loans (based on similar cash flow models) – i.e. a 2% to 4% charge on that portion. Recent shared equity schemes in the UK have blurred this distinction, with rent or interest being payable on the equity share not owned after five years.

[4] The term 'staircasing' is commonly used to describe the ability for purchasers to acquire further increments from the partner under shared equity arrangements.

required otherwise to support an equity loan, and to create a pool of lower cost homeownership opportunities for the long term.

1.4.4 Subsidy forgiveness

Programs based on subsidy forgiveness (a fourth component of the typology identified by Jacobus and Lubell (2007) in their continuum of strategies for preserving affordable home ownership) are not considered forms of shared equity and, therefore, are not the focus of this research. Nevertheless, this is the principal lever currently used in Australia to promote access to home ownership for first time buyers, for example through First Home Owner Grants (FHOG) and stamp duty concessions. This approach has also been used in past initiatives to stimulate low cost home ownership, for example through land price discounts or mortgage interest rate subsidies.

1.5 Current state and territory initiatives

In the last few years, shared equity arrangements have seen significant growth in Australia. Indeed, Australia has probably one of the most developed landscapes of shared equity programs in place. Most states and territories now have schemes operating, although a number remain on a relatively modest scale (see table 1). More substantive engagement has occurred in jurisdictions where government-backed, arms-length agencies remain an integral part of local institutional and funding frameworks. For these organisations, shared equity provision has signified a key innovation within their product portfolios, providing a response to growing housing affordability constraint and continued commitment to assist lower and moderate income households into homeownership.

Table 1: Government shared equity loan products/schemes, Australia

State	***Provider***	***Shared equity products***	***Website***
Western Australia	Keystart Home Loans	→ Good Start → First Start → Restart	www.keystart.com.au
South Australia	HomeStart Finance	→ Breakthrough → Equity Start	www.homestart.com.au
Northern Territory	Territory Housing	→ HOMESTART NT	www.housing.nt.gov.au/home_ownership
Victoria	VicUrban/ Burbank Homes	→ Ownhome	www.burbank.com.au/ownhome/about.php
Queensland	Queensland Department of Housing	→ Pathways	www.housing.qld.gov.au/loans/home/loans/shared/index.htm
Tasmania	Housing Tasmania	→ HomeShare	www.dhhs.tas.gov.au/_data/assets/pdf_file/0003/36463/0244_HT_HomeShare_DL.pdf
ACT	The ACT *Affordable Housing Action Plan 2007* signalled a role for shared equity encapsulating sale of public housing dwellings to eligible tenants, and mechanisms to support eligible lower-income and first time buyers.		
NSW	No current schemes		

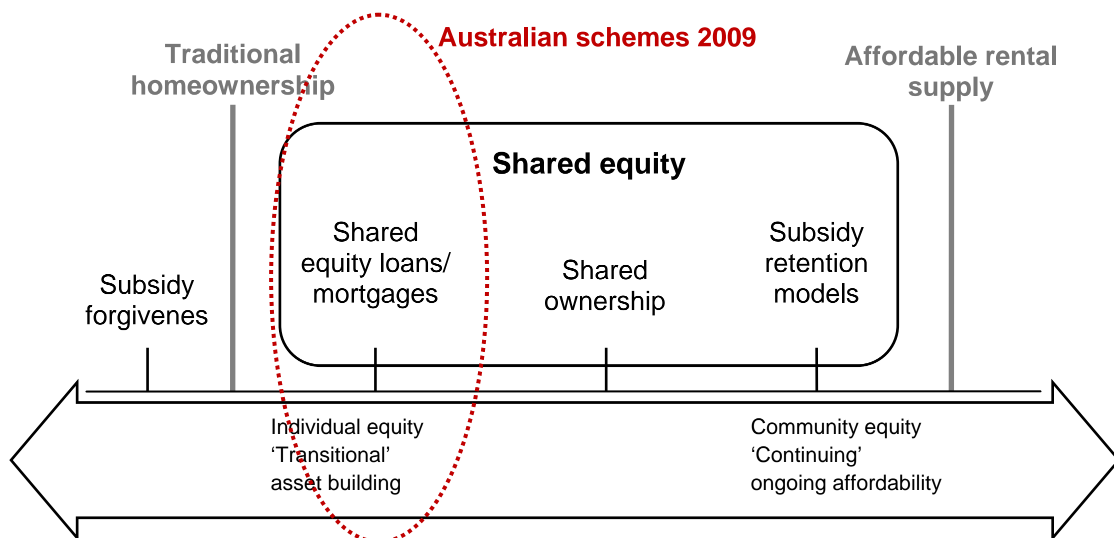
Source: State/territory housing, Burbank, HomeStart and Keystart websites

The Northern Territory's HOMESTART NT (recently rebranded from HomeNorth Xtra) has the longest track record, assisting over 1000 households since its launch in 2004 (Northern Territory Government, 2007). Both Keystart (WA) and HomeStart (SA) introduced shared equity initiatives during 2007: First Start and Breakthrough respectively. First Start's launch was underpinned by a $300m commitment to provide up to 3000 loans between 2007 and 2010 (Department of Housing and Works, 2007). By late 2008, over 2500 loans had been made, and the success of the scheme led to additional funding – although tied to a tightening of eligibility criteria (see Chapter 3). HomeStart also had a successful year with Breakthough (around 200 customers), and combined with the continued success of Equity Start – targeted at social housing tenants – saw shared equity arrangements providing the leading business growth area for 2007/08 (HomeStart Finance, 2008).

Other initiatives remain on a smaller scale, Further to the first two ballots held in 2007, a small number of dwellings have been made available for purchase under Victoria's Ownhome scheme (Donovan, 2007). Queensland's Pathways scheme was launched in 2008. It is focused on assisting social housing tenants purchase their homes through shared equity arrangements and is likely to have relatively limited take up. Housing Tasmania have also launched their HomeShare initiative in recent months, which is targeted at both social housing tenants as well as other lower income first time buyers, enabling them to purchase new build property throughout the state.

These government-backed schemes are essentially designed as 'transitional' or 'individual equity' arrangements, geared towards providing a step onto the property ladder rather than subsidy retention models (see figure 3). Although there are some supply side aspects (for instance, some of the products are tied to existing social housing stock or allocated new build), schemes lean heavily towards demand-side responses. The initiatives have broad principles and characteristics in common but also variations that reflect factors such as the historical trajectory of government engagement as a social housing provider or financier of home loans, the particular housing market context of the state/territory (relative house prices, average incomes) and how this is reflected in strategic policy.

Figure 3: Positioning Australian schemes



Source: Adapted from Jacobus and Lubell (2007)

1.6 Stage One findings

1.6.1 Literature and policy review

A review of current Australian schemes acknowledges the important legacy of low start loans and the success or otherwise of these arrangements for the contemporary shared equity landscape at the state/territory level. In terms of 'government-backed' schemes, those jurisdictions where significant fall out was not seen in the early 1990s are those where successful schemes have been able to develop. Private sector-led initiatives – and in particular Rismark's Equity Finance Mortgage (EFM) product, are also considered. An overview of international perspectives and schemes picks up on recent experiences in the US, UK and the Netherlands.

A series of guiding policy questions and considerations within the literature are also identified. These are: an understanding of the potential demand for, and scale of, possible schemes; eligibility criteria that will help to shape the targeting and take-up of limited public resources and help justify government support and/or subsidy; and potential externalities and adverse impacts that a new intervention may have on existing housing market conditions or other related policy areas.

1.6.2 Interviews with institutional stakeholders

Seventeen interviews were conducted with mortgage lenders, policy officials and other stakeholders in the housing finance industry with interests in shared equity arrangements. Discussions aimed to explore industry perspectives on:

- Different shared equity models and their potential role.
- The impacts such products might have in terms of access to home ownership and on the wider housing market.
- The potential perceived for both government-backed schemes with lender equity loans and a fully functioning private sector-led market with lender/investor equity loans and mortgages.
- Whether, and how, government and lenders need to work together to underpin shared equity loans and their policy and regulatory implications.

Although Australia can be considered a market leader in private sector-led shared equity development and investment mechanisms that assume no direct public subsidy, dialogue between lenders and government has arguably been less concerted here than overseas. In part, this can be viewed as a response to the existence of government-backed agencies, which have developed viable schemes in the states in which they operate. Our discussions highlighted lender interest, mediated by a significant degree of caution. This tentative position – even prior to the onset of the credit crunch and global financial crisis – is instructive, and echoes limited private lender appetite identified in Pomeroy's (DCLG, 2008) follow up to the UK's Shared Equity Task Force (DCLG, 2006).

- Several lenders questioned the rationale for shared equity. For some, it represents a complex response to well-understood 'market failures'. Traditionally, they have adjusted products and pricing to help those on the margins of homeownership within the market, rather than through 'quasi-arrangements'.
- Identification of a targeted 'intermediate' market raises questions for lenders about whether it is a temporary market while prices are high, or a permanent market with temporary 'residents' who move through to the mainstream market.

- Lenders reported concerns about risk to reputation and the costs involved in bringing products to market. Risks are seen to be heightened by uncertainty of loan behaviour and lack of track record with the products.
- Lenders noted potential problems arising from any divergence between house price and income growth on a borrower's capacity to buy out the loan. This might constrain normal market mobility.
- Several areas where government commitment would be required irrespective of particular policy goals or levels of subsidy were identified – for extending data and information sharing and addressing taxation and regulatory matters.
- There was some concern that policy involvement risked complicating product development. However, many lenders considered government participation appropriate, and necessary, as a means of 'cushioning' added risks.

1.6.3 Interviews with existing customers

Nineteen interviews were conducted with homeowners using Keystart, HomeStart and Homenorth products across WA, SA and NT respectively. As the interviewees comprised both recent customers alongside purchasers who had owned their property for some time, the interviews provided the opportunity to consider how consumer views evolve over time. This spread provided insight into how perspectives adjust as customers 'live' with shared equity arrangements, through changes in the housing market, in the wider economy, and in their personal household circumstances.

Insights from our interviews helped identify key issues and considerations shaping the relative attractiveness and take up of current schemes. Clearly – and this can be identified among both the very recent and the more established customers – the schemes have proved popular:

- Early satisfaction with schemes rolled out recently in WA and SA demonstrates the appeal of shared equity approaches to those struggling to get into the market. The longer-term experiences of HomeNorth customers provide a more tempered, but nonetheless positive, view of shared equity arrangements.
- Schemes have allowed customers to purchase appropriate housing (within reason) suitable to their household needs although many had to move out to areas where prices were more affordable.
- Being able to purchase through the open market (rather than being tied to specific supply) was valued.
- Most interviewees felt that they would not have been able to purchase without assistance. However, it can be argued that it allowed some to purchase sooner than they otherwise would have been able to. Some met eligibility requirements as a result of temporary circumstances, for example, time out from the workplace.
- The complexity of shared equity arrangements is often identified as a barrier to consumer interest and scheme take-up. However, our interviewees were able to explain how the concept of shared equity worked and what it meant for them.
- Concerns were related primarily to future uncertainty: understanding what happens when they come to sell or how they might meet obligations placed upon them by the scheme in time, for example being forced to purchase additional equity.
- Ongoing perceptions were shaped more by future hurdles than benefits already acquired. Significantly, customers were more concerned about the part-share of the property they do not own than about the gains that they have made.

Together, these initial findings offered up-to-date contextual and behavioural insights helping frame areas of interest explored in the second stage of research. They helped confirm the target groups for the consumer focus groups, and the submarkets within Australia's three largest cities where they should be held. The findings also confirmed interest in exploring two different types of shared equity in depth, and the core issues that should be raised in group discussions in order to determine interest and viability.

1.7 Structure of report

Further to this introduction (Chapter 1), this report comprises four chapters.

In Chapter 2, we present the findings from ten consumer focus groups held in lower and moderate value housing market locations in Sydney, Melbourne and Brisbane. By exploring two schemes in detail (one representing 'individual' equity arrangements, the other 'community' equity), the key elements and aspects of each scheme, driving or deterring potential interest, are identified.

Chapter 3 addresses the complex interplay between housing markets and shared equity arrangements. Firstly, we consider how eligibility criteria for schemes are determined in the context of particular market conditions; how schemes respond to market dynamics over time; and what impacts different spatial market contexts – between States, within cities – have on initiative design and feasibility. Secondly, we explore this relationship not only in terms of addressing barriers to accessing homeownership, but also recognising that market dynamics shape and determine the ongoing appeal or otherwise once shared equity arrangements have been entered into.

Chapter 4 explores how shared equity is financed and the financial contexts within which schemes currently operate in Australia and overseas. Looking across an increasingly blurred government/market interface, we approach this nexus from both directions. Firstly, we review the financing arrangements of government-backed agencies, outlining the similar structures within which these schemes operate, but also highlighting differences in terms of governance and flexibilities to act as full commercial concerns. Secondly, the role of private-sector, 'market-led' engagement is considered, including innovation in the financial markets to foster a conducive framework for lender, investor and consumer interest in shared equity. We discuss the significant impact of the global financial crisis, certainly in the short- to mid-term, in this regard.

In the concluding chapter (Chapter 5), we focus upon policy and funding considerations, and discuss options for institutional arrangements that maximise the housing outcomes desired. In this regard, we clarify the nature and scope of a potential policy framework for shared equity – for example, subsidy requirements, accountability mechanisms that would be desirable to manage risk, and at what *scale* policy interest should focus.

2 CONSUMER VIEWS OF SHARED EQUITY

2.1 Introduction

This chapter reports the findings of focus group discussions held in June 2008 with potential shared equity consumers in lower/moderate value housing market locations across Metropolitan Sydney, Melbourne and Brisbane (i.e. the major markets which currently have no access to significant government-backed shared equity schemes).

2.1.1 Sampling and recruitment

Ten focus groups, each involving up to eight participants, were recruited with the assistance of Sweeney Research Ltd. Across the locations, it was decided that groups would be stratified according to household income in two broad ranges ($40,000-$55,000 and $55,000-$80,000). Although primarily interested in prospective first homebuyers, those seeking to re-enter the housing market were also identified as an important group. While recognising that a number of existing state and territory schemes aim to assist existing public housing tenants move into homeownership, it was decided not to sample, and hold group discussions, based principally upon tenure. In part this reflected the likely difficulty of recruiting tenants in our field study States where such schemes are not currently available. It also reflected a further level of complexity in terms of exploring product design, since public housing tenant-focused schemes typically have different arrangements to initiatives targeted more widely. Nevertheless, the research succeeded in picking up public housing tenants within the income parameters of the sampling framework.

Table 2: Selection of focus group participants

Sampling	*Basis for selection*
Household income	Groups differentiated into two income bands ($40,000-$55,000, $55,000-$80,000). The literature indicates that equity sharing arrangements geared primarily towards asset growth of individual households are more viable/appropriate for households with incomes towards median values. Community equity models, where a greater proportion of the property is held by the partner, are potentially more viable for/of interest to lower income households.
Location	Groups in lower and moderate value locations in Sydney, Melbourne and Brisbane: → Inner/middle gentrifying suburbs. → Middle/outer areas that provide 'feeder' communities for starter homes often on the fringe.
Age group	Mainly first-time buyers (25 to 39 years), plus representation from those in older age groups yet to purchase or seeking to re-enter the market.

Table 3: Focus group details

Group No	*Criteria*
1 – Coburg, Melbourne	Low to moderate household income ($40,000-$55,000)
2 – Coburg, Melbourne	Moderate+ household income ($55,000-$80,000)
3 – Sunshine, Melbourne	Low to moderate household income ($40,000-$55,000)
4 – Petersham, Sydney	Low to moderate household income ($40,000-$55,000)
5 – Petersham, Sydney	Moderate+ household income ($55,000-$80,000)
6 – Liverpool, Sydney	Low to moderate household income ($40,000-$55,000)
7 – Liverpool Sydney	Moderate+ household income ($55,000-$80,000)
8 – Springfield, Brisbane	Low to moderate household income ($40,000-$55,000)
9 – Springfield, Brisbane	Moderate+ household income ($55,000-$80,000)
10 – Carindale, Brisbane	Moderate+ household income ($55,000-$80,000)

2.1.2 Exploring two shared equity models

Based upon discussions with existing customers, institutional stakeholders and initial assessment of market context, it was decided that two shared equity models – representing 'individual' and 'community' equity perspectives respectively – would be considered in focus group discussions with potential consumers.

The approaches in place in a number of Australian states/territories are based on maximising individual household equity and the potential of the household to step up to full ownership. In 'community equity' models (typically tied to a particular supply of housing), the partner representing the community interest retains a greater proportion of equity gain, helping retain greater control over preserving affordability in that stock for future households. While these models (for example, community land trusts) are well developed in the US, they have received relatively little attention in Australia to date. However, a number of factors point towards the value of considering community equity models in the Australian context.

- The first relates to the potential for such schemes to contribute more significantly to a strategic and comprehensive affordable housing strategy, such as outlined in Yates and Milligan (2007).
- The second is tied more to the realities of contemporary housing markets; particularly that shared equity models are more successful if conducive factors align (and hence less so if they do not), and at particular stages of the market cycle. While such conditions can be identified in some markets – where the gap between rising incomes and rising prices can be bridged with limited subsidy for the short to medium term – in others, the income price gap may have become too stretched to make these forms feasible for governments or consumers.

In order to avoid unnecessary complexity, existing 'tried and tested' models were selected rather than the research team developing hypothetical, hybrid or indicative schemes. The specific models of each type selected to frame discussions were:

- 'Individual equity' = WA First Start www.keystart.com.au/key/SharedEqBrochure.pdf
- 'Community equity' = Rick Jacobus' subsidy retention model www.rjacobus.com/resources/archives/home ownership/000625.html

2.2 Areas of discussion

Group discussions were structured to tease out the key drivers shaping potential interest in both shared equity initiatives. The chosen models were 'rebadged' with a generic name for use in the focus groups and walk-through examples of how such schemes work were provided. A strength of using products that have been introduced successfully was the degree to which clear existing documentation could be drawn upon for testing. In each group, one of the two schemes was used to provide the primary focus for discussions, however all groups had the opportunity to consider both and offer opinions of the relative strengths and weaknesses of each scheme.

Table 4: Models for focus group discussions

'Firsthome' ***First Start (Aus)***	*'Yourhome'*[5] ***Jacobus subsidy retention (US)***
Characteristics	***Characteristics***
→ Transitional: focus on access	→ Access plus ongoing affordability
→ Lower/mid income households	→ Working lower income households
→ Promote staircasing	→ Promote stability
→ Do not protect subsidy long term	→ Protect subsidy in the long term
→ Typically not tied to new supply	→ Typically tied to new supply
Similar example models/schemes	***Similar example models/schemes***
→ SA Breakthrough (Aus)	→ Firstbase (UK)
→ Scottish Homestake (UK)	→ Slimmer Kopen (Netherlands)

The following issues were explored:

- → **General discussion about housing, current situation, barriers to ownership** (current housing circumstances, length of time looking to buy, buying on own/in a couple, barriers faced – deposit/prices, understanding of the local housing market)
- → **Seeking finance** (experience with banks and lending agencies, experience of trying to get a home loan, understanding of other forms of 'innovative finance')
- → **Scheme overview** (points of clarification, advantages and disadvantages, relative attractiveness of shared equity vis-à-vis alternative 'innovative' schemes)
- → **Sharing equity** (general understanding, preferred distribution of equity shares between purchaser and partner, trade-offs in entry, repayment costs versus amount of equity accrued by the household)
- → **Partnership arrangements** (preferred partners in relationship, role and nature of relationship with partner, administration of schemes: government department, government financier or mortgage brokers)
- → **Living with shared equity** (upward/downward staircasing, understanding of costs associated with buying additional equity shares in the property, assessment of risk, arrangements tied to payment for equity share not owned)
- → **Moving on** (how improvements and renovations should be valued and accounted for in equity sharing arrangements; what happens at time of sale)
- → **Targeting** (who should be benefiting from shared equity opportunities, relative importance of schemes preserving affordability versus schemes maximising opportunities for individual equity gain).

[5] The 'rebadged' name given to the community equity scheme for group discussions bears similarity to a scheme now in operation (although of very different design). To avoid any conflation in the context of this report, this has been relabeled Yourhome; this change has no impact on the findings as presented.

The lead scheme was rotated, with half the groups focusing first on the 'community' equity model ('*Yourhome*'), and half on the 'individual' equity model (*'Firsthome'*). With our participant profile also distinguishing between low and moderate income groups, there was a guiding hypothesis that the community equity model may have been more appealing – and certainly more viable – for lower income groups. At the appropriate point in group discussions, participants were provided with a 1-2 page handout to read independently before coming back to the group to discuss. Summary versions of the handout for *Firsthome* and *Yourhome* are provided in the respective sections below.

While all groups were provided with the same information and walk-through example, a number of small iterations were made as part of the research process. In one group, shorter versions of the handout were tested to see if they were able to stimulate the same, if not more, level of discussion (they did not) and, in later groups, words or phrases were either removed or rephrased to see if they helped tease out issues influencing participants observations (similarly, they did not).

In all cases, the handouts provided sufficient information to understand how the schemes worked, but they deliberately built in a degree of ambiguity on a number of key points, or did not cover all the caveats and detail required to make a fully informed decision. The intention was to get respondents to be left with a number of questions and 'what ifs?' which provided for rich discussion within the groups.

2.3 Participants' current housing context

The research aimed to focus on views regarding particular shared equity schemes and products rather than re-rehearse consumer awareness and propensity towards the idea of shared equity per se. Nevertheless, introductory discussions within the focus groups helped to provide context, building up a picture of housing histories of the respondents, and the respondents' positions within the complex trajectories towards homeownership. It had been expected that many participants, and certainly those that had actively sought out mortgage finance, would have been made aware of 'alternative' or innovative options for accessing homeownership, but probably not the actual shared equity arrangements that formed the focus of group debate and consideration.

Although the respondent profiles of our focus group inevitably reflected the recruitment criteria stipulated, it is important to note that the potential shared equity customer is not always the mid 20s-early 30s working family seeking to buy their first home. Groups included those who, for a variety of reasons, had reached their 40s and 50s and had not yet bought, and those who had fallen out of homeownership as a result of divorce and were seeking to purchase again. Other variations were seen among those seeking to buy individually or with partners, those who felt their incomes would grow over time and those who felt they would not, and in terms of their attitudes towards saving for a deposit. While many of our respondents demonstrated the oft-cited characteristics of people struggling to get onto the housing ladder, the range and combination of factors, wrapped up in particular household histories, highlighted the complex parameters within which policies related to supporting access into homeownership operate.

Factors shaping participants' experiences of, and aspirations, to get a foot on the housing ladder included:

- → Saving for a deposit.
- → Accessing finance.
- → Awareness of 'alternative' or innovative products.

2.3.1 Saving for a deposit

Raising funds for a deposit inevitably represented a barrier for many, with the cost of rent, and bills (both expected and unexpected), competing with opportunities to save. With most looking to purchase properties towards median values in their area ($350,000-$450,000), the sheer task of saving upwards of $50,000 was perceived as an insurmountable task. Even if they were able to make trade-offs and start saving in earnest, the kind of figures involved meant that a number felt it simply unrealistic and out of reach.

A number had considered taking out mortgages with little or no deposit and therefore high loan to value ratios (95%+) on the basis that it was the only option. For a number, it was argued that since they were already going to be borrowing a considerable sum, why not borrow the additional amount rather than save and wait.

However, many respondents were adamant about ensuring that they had a decent deposit, even if it led to the postponement of purchase, or a struggle in terms of trade-offs made in lifestyle in order to build up savings. For some, a 'good' deposit translated into a dollar figure, for others, at least 10, and ideally 20, per cent was the goal. Some had been saving for a number of years and adopted strategies such as working additional hours, continuing to live in shared arrangements longer than they would have ideally wanted, or moving back home with their parents in order to save. Although many renters talked about the notion of rent being 'dead money' as an important driver in wanting to own their own place – they would rather be paying off their own home than someone else's – a strong degree of pragmatism also came through.

A number of respondents had previously been homeowners and were aware of the on-going costs typically involved. Others had seen family members or friends struggle with the burdens of ownership, especially in the light of the multiple interest rate increases seen up to mid-2008, and this led to acknowledgement that renting had its plus points, not least enabling them to trade off and retain certain lifestyle choices.

In each of the metropolitan areas, focus groups were held in inner, 'gentrifying' areas – such as Marrickville in Sydney's inner west and Coburg in north Melbourne – and many of the respondents living in these areas emphasised the importance of location. Homeownership was likely to be more attainable if they were to consider living on the fringe, but the trade-offs provided by their current location were clear.

'I've looked and then given up because I thought there's no way I can afford – on my own, I couldn't afford – I mean I've got no savings at all now … I then thought if I decide to save it would take like $80,000 …no way I could get anywhere near that.'

Liverpool, moderate income, female

'We thought we'd have to go 110 per cent for the $310-320,000 because we wouldn't have a deposit… It was the only way and we just hoped that we would get promotions or we don't have kids for a long time to be able to work ourselves up to be able to afford to have kids at a certain time. But then you hold off on your life because of money and things.'

Springwood, lower income, female

'I mean I checked out how much – based on my wage – how much I can borrow and even when that was stretched, you can just see how much your repayments are and you go God, there is no room here for – should something happen.'

Liverpool, moderate income, female

'I slowly have been saving to buy my own first home. But yeah because my sister's bought her own unit just up at Flemington, and I've seen the struggle that she's gone through to actually make the payments. It just ruins basically her life of not going out or anything, so, you know, I'm still fairly young, I like going out every now and then.'

Sunshine, lower income, male

'For me it's the long term commitments. You never know what's going to happen. I don't want to funnel everything I earn into something and possibly lose it ...I know it's paranoid, but I do feel like it will take a lot of energy to maintain it ... I'm thinking there are better things I can do with my money, other things.'

Petersham, moderate income, male

2.3.2 *Accessing finance*

Difficulties in accessing a home loan through a mainstream provider were raised by a number of respondents. This might have been due to being self-employed or working in occupations where income was variable and uncertain. Others had a range of long-standing debts or ongoing obligations that the provider necessarily took into account in determining eligibility and potential borrowing capacity. A number suggested that marital breakdown, child support, and the costs of moving on compounded the difficulties of getting finance.

While many respondents were eligible for mortgages with those they had approached, their borrowing power was insufficient to purchase anything in their target markets. For those on $45,000-$55,000, a loan offer of $180,000-$200,000 offered little potential where entry properties in the market are towards double this amount.

Others, however, found providers willing to lend them far greater amounts than expected. Generally this was seen unfavourably, and those respondents who had been offered generous figures in comparison to their incomes and expected future incomes, expressed concern about the risks of being stretched in this way.

Whether in the position of having been offered insufficient or somewhat extravagant funds, most respondents were very clear about their goals: they knew how much they needed to buy something appropriate, and the amount they wanted to borrow as a proportion of this figure.

For those who had 'entered the zone', were saving aggressively, and had started to look at properties and explored finance options, their desired borrowing capacity (and hence property value range) was informed by a range of strategies. For some, this meant keeping track of what repayment rates would be and making sure that they saved the difference between this and their rent; some couples tried to live off one of their incomes to test their exposure if one were to lose their job. Far from the oft-perceived overstretching of first time buyers fuelled by generous mortgage multiples, the cautious strategies of many participants, underpinned by their commitment to getting a big deposit in place, indicate that an important barrier to home purchase is sensible risk aversion.

Ever-rising house prices were seen as inevitable, and this fuelled frustration for many that delays to buying fed into a vicious cycle, as the goal posts continually shifted. With the groups held in June 2008, the three cities were all at the tail end of a long boom where prices had

'I've actually had mortgage brokers do quotes and stuff in-house for me and still the amount of money that they're only offering because of my wage. I've got a small car to finance and it wasn't even a huge amount that I borrowed. They'd only allow me to have like 200,000 or 230,000. Like are you for real? What can I buy for that?'

Sunshine, lower income, female

'My partner and I got approved, and we're only thinking about $350[000] and now we've taken it up to $400[000], but the banks would lend us $700[000]. How on earth could you pay that back and still live?'

Coburg, lower income, female

'I use a spreadsheet. I have actually a couple of spreadsheets. I put in what I would pay for repayments, what I would pay in rent, what I would pay on my credit card, what I would pay on my car or whatever. It's just like tick, tick, tick, See if they're any negatives in that for like over a five year period then it doesn't work. I change the repayments and keep on going ...'

Petersham, moderate income, female

'We said before we work on one [home loan repayment calculation] – can we pay it off in one income. That's what we based it on, knowing we want to start a family ... yes that's what you need to do, that's what my husband and I looked at. If one of us fell ill, or one of us lost an income, could we afford to struggle on one income, and pay the mortgage?'

Coburg, lower income, female

increased dramatically in the preceding five to ten years. Those price pressures continued to be apparent in Melbourne and Brisbane, although the market had become more subdued in Sydney by this time, and indeed Sydney's west had started to see significant falls in property prices.

This introduced more considered discussion of market uncertainty, and a number noted that the timing of purchasing decisions was not only determined by individual financial barriers, but also concern about not entering an overheated, overpriced market. This was tempered to a degree with respondents suggesting that they would be buying for the long term, however a number questioned whether, given the current weak performance of the market and further price falls, they might cease to feel the urgency that was there whilst prices continued to rise.

'One of the things that's central to me at the moment is things seem so overpriced … It just seems crazy buying a house at these prices.'

Carindale, moderate income, female

'That's the other thing. You think, am I a fool for looking right now? What's going to happen? A year ago, things were on the rise, but it was steady. You sort of knew what was going to happen. But now things seem unpredictable. There are all things like crazy reports of recession …'

Petersham, moderate income, male

2.3.3 Prior awareness of 'innovative' products

Awareness of 'innovative', 'different' home loans among participants was largely limited to variants of fixed, variable or offset products. Most were aware of low-doc and 100 per cent loans, and typically expressed caution towards such arrangements.

When prompted, a number of participants mentioned rent-to-buy initiatives, often tied to earlier Housing Commission schemes in a number of states. Others also noted that they had seen fly-posters for rent-to-buy arrangements, whereby participants rented for a period with a percentage of those payments contributing to the down-payment on that property. A number knew of people who had looked into (and dismissed) such options, although one noted that they had a couple of friends for whom such arrangements had worked, although they had needed parental help to put down a bit of equity at the time of 'transitioning' to ownership.

As expected, only a few participants were familiar with the concepts of shared ownership and shared equity, or aware that such schemes existed in other states. One or two had heard of schemes in other countries and on further prompting, a small number recalled hearing about schemes that meant you could buy 'half a house', although recollection as to how such arrangements worked was limited.

A number noted that they were exploring the idea of buying with friends. They had typically been renting for a long time, and saw pooling their resources together as a means of getting a foot on the housing ladder. It was assumed that such arrangements would be enabled through a 'normal' loan rather than seeing this as an arrangement with third party involvement.

'There was that [scheme where the] bank goes half with you? ... they were pushing that about 2-3 years ago now. You only paid half the loan or something and when you sell it, they get half the money, or half the value of the house as well? I remember just looking at it going, well...'

Coburg, moderate income, male

'They do that in South Australia, rent to buy, through the public housing system ... which is great for a lot of people that aren't in a position to do normal buying on their own.'

Coburg, lower income, female

'There's some of those in the UK ... a lot of them are £99,000, and I'm going why £99,000 for a house? And when I looked into it, it's because you buy a portion, like you half own a house, and then you might pay rent and co-own.'

Sunshine, lower income, female

'I've been talking with some friends of mine … we've been talking about co-contributing and they would get the deposit together, and then we'd all go in and, because we're all paying rent separately, so we're paying towards the contribution, pay it off, sell it, divide it by the equal payments and then start again.'

Sunshine, lower income, female

2.3.4 Introducing the schemes

The following two sections (2.4 and 2.5) provide a brief overview to participants' immediate responses to *Firsthome* and *Yourhome*. Key distinguishing features of each of the schemes, shaping participants' understanding and perceptions in each case, are explored under these headings. However, much of the discussion cut across both. Key themes in this regard – partnership arrangements; what happens over time when moving or wanting to remortgage; and who participants felt should benefit from any assistance provided by government for such schemes – are explored in Section 2.6.

2.4 Firsthome

Box 1: Introducing the Firsthome scheme

The *Firsthome* Shared Equity scheme is designed to help low to moderate income first homebuyers into homeownership. Under the scheme, eligible homebuyers may purchase a home in conjunction with a partner. In this case the partner is a government agency, but it could be a bank or developer.

The scheme can assist first homebuyers in two ways:

- It only requires a small deposit, either $2000 or 2% of the total purchase price. Purchasers are still eligible for the first homeowners grant, and no lender's mortgage insurance is payable.
- It helps with on-going costs because home loan repayments are made only on the share of the proportion of the property you own, and not on the partner's share.

The relative shares owned by you and the partner will depend on your income and household size. For example you might purchase a 70% share, with the partner holding the remaining 30% share.

You enjoy all the rights and responsibilities associated with owner occupation. You are also responsible for all bills and maintenance.

Over time, you can increase your ownership in the property whenever you can afford to – so, for example, if you started with a 70% share you might buy a further 10% to take your share up to 80%. When you wish to do so, the property is independently valued. The cost of buying that share will be based on the market value of your home at that time. In time, you can purchase 100% of the property.

You can sell your home at any time. If you wish to sell, an independent valuation will be conducted. The partner has first option to purchase the house at that valuation. If not, the property is sold on the open market.

Who can take up the scheme?

Eligibility criteria apply with a maximum income allowed, so the scheme is not available to everyone. The amount you can borrow will be related to your assessable income and will take into consideration other commitments (such as credit card and/or personal loans) you may have. There is also a maximum purchase price set varied by area.

An example of how it works

Kevin and Tanya are in their early 30s, have two small children and their combined household income is around $65,000. They describe themselves as a typical working family. They've made enquiries at the banks who will lend them around $250-$275,000. A first home in their area costs towards $350-$375,000. Being able to buy their own place seems out of reach.

Under the *Firsthome* scheme, they purchase a 70% share of a property valued at $350,000. This means that they borrow $245,000 (70% of market value). The partner's share is valued at $105,000 (30% of market value).

Five years later, Kevin and Tanya decide to sell. Let's assume they have not increased their equity share since they bought the property.

If the property sells for $450,000, then Kevin and Tanya are entitled to $315,000. This represents their original 70 per cent share, plus 70% of capital gains made. The partner is entitled to $135,000. This represents their original 30% share plus 30% of capital gains made.

2.4.1 Understanding/initial reactions

It is often noted that a barrier for shared equity take-up is the complexity of its customer proposition: the concept is not easy to explain, and introduces different considerations for buyers compared to outright purchase. However, the degree to which the issues were understood after an initial reading of the *Firsthome* scheme was highly instructive.

Broad principles underpinning the scheme were quickly grasped by the majority of participants. Arguably harder elements of the product proposition such as partner interests, arrangements for sharing equity, and the purchase of additional shares, were freely articulated and the perceived benefits and disadvantages discussed.

As expected, as debate delved down into aspects of the scheme in greater depth, participants weighed up issues acknowledging that it was not a silver bullet: although such arrangements provided a means of accessing homeownership it did so with a number of conditions. It was a pragmatic view however, with many participants reflecting that any potential downsides were inevitable given the trade-offs represented by the partner's interest. Questions of fairness shaped groups considerations when discussing these trade-offs.

Benefits in terms of addressing barriers to entry – the need for only minimal deposit, no mortgage lenders' insurance, and lower ongoing home loan repayments – were noted. Although it had been these issues that had occupied prior discussions regarding the difficulties they faced in getting a foot on the housing ladder, participants quickly moved onto whether aspirations driving their desire to be homeowners were enabled by the scheme.

In this context, discussions honed in on aspects of the scheme that assisted these goals. Although security and stability were important, the focus was on the freedom of choice, of being able to make their mark, and, if not at the outset, over time, that the property could be 100 per cent theirs.

'This one [Firsthome] is more like helping you do what you would normally realistically be doing which is why if the house goes up in value and then – that's where a lot of people make the money. It's that foot in the door thing.'

Springwood, moderate income, female

'It's probably similar to having a family member help you out … They own the other percentage, and then you end up paying them off if you want the extra amount, if you want to own the property. Otherwise if you don't want to own the property, you just split the profits from the sale.'

Liverpool, lower income, male

'I'd be happy to have 70 per cent of $500,000 if I'd only paid 70 per cent in the first place and it got me in there … if you can't afford the whole amount you can't afford the whole amount, so you can't cry about it because you've got what you've got and that better than not getting – for me, I could have got in and now I might have $300,000 in equity which instead I've got bugger all and the debt still.'

Springwood, moderate income, female

'I'm warming to it and I think that's really great, because it gives people the choice. They can choose where they want to live, what suburb. They can stay in the same suburb and kids can go to the same school. It gives them freedom. I think it's more dignified, for some reason.'

Petersham moderate income, male

It was these instincts, rather than upfront benefits, and arguably consideration of longer-term issues tied up with equity sharing arrangements that drove interest or otherwise: most participants were looking for a stepping stone that helped them realise 'the dream', rather than a variant thereof.

2.4.2 Sharing equity, 'staircasing'

Most participants quickly understood how shared equity arrangements would work with *Firsthome,* describing it as 'going in with someone', 'sharing the profits', or 'someone investing with you'. Although some focused on the implications of partnership in the form of 'lost' equity gains at the time of sale, most recognised that trade-offs were inevitable. It was generally agreed that the partner should benefit in return for the upfront assistance offered, although there was some debate as to the extent of that benefit. If a government agency was involved, some felt any gains should be moderated, or any profits recycled to help others take advantage of the scheme.

Participants felt that those taking up the scheme would be fully aware that they were being provided assistance at the outset. As with any major expense, it was argued that people should know what they are signing up for: shared equity is a different proposition to full ownership with its own particular advantages and disadvantages. Some noted that it was a question of choice if you entered into the relationship on those terms – 'it's not forced upon you'.

The mechanics of equity sharing were explored in more detail through discussions looking at increasing shares over time through staircasing. Again, the costs involved in doing this, and how value would be calculated at the time of purchasing that share, were understood and seen as fair. Many expressed expectations that they would 'build up to 100 per cent' as quickly as possible, but the options to potentially 'step down' if hit with changed financial circumstances were also raised.

A number of the groups picked up on the risks of a rising market and the cost of further shares (an issue considered in more detail in relation to 'moving on', discussed below). While some felt that there needed to be some certainty about how much those extra shares might cost at the outset, most recognised that it is a market arrangement and, like any homeowner, you are subject to the risks as well as benefits of rising or falling prices.

[On discussing the partner taking their share]

'... You know that going into it.'

'... That's something you know the minute you sign on. And it can be the difference between owning a house and not owning a house.'

'... I mean, they're taking all the risks too, because they know that it could all go belly up. They know that the market could drop out tomorrow and they're going to lose.'

Coburg, lower income, group discussion

'You go into this choosing to go into it knowing that you are a homebuyer of ... percent of a property. It's not forced upon you … you know that you're going to come out of it with something rather than renting for the next 50 years.'

Springwood, lower income, female

'You'd hope that the money they'd make from this would somehow go back into reinvesting into keeping housing affordable. So the money we're making off the capital gains would rollover into new initiatives that would help new people.'

Sunshine, lower income, male

'It could go up or down so … you can't just say I'll buy it only if the market's gone down. You know what I mean? You can't make your rules based on the market.'

Petersham, lower income, female

'In a bet, which this is what it basically boils down to, then tough luck. It's the future playing the stock market and you stock goes down then oh well actually I really wanted it at its old value, not at the current value. Can I have my money back? It's like somebody had a bet and they lost.'

Petersham, lower income, male

'It's a gamble ... You're still better off than renting. At least you've got your foot in the door regardless of how the market is in five years time.'

Petersham, lower income, male

2.5 Yourhome

Box 2: Introducing the Yourhome scheme

The *Yourhome* scheme is designed to help low to moderate income first homebuyers buy their own home.

Under the scheme, eligible homebuyers co-own a home with a partner. The partner is a 'not-for-profit' Community Trust that builds affordable housing across the city.

The relative shares owned by you and the trust will depend on your income and household size. For example you might purchase a 50% share, with the partner holding the remaining 50% share.

The scheme assists homebuyers in two ways:

→ It helps with initial costs because the scheme only requires a small deposit. Purchasers are still eligible for the first homeowners grant, and no lender's mortgage insurance is payable.

→ It helps with on-going costs because repayments are made on the share of the proportion of the property you own, and not on the partner's share. So if your share of the property equates to 50% of a market value of $300,000, then your home loan is for that 50% share ($150,000).

In exchange for the trust's assistance in buying the home, the homebuyer agrees to limit the price at which they can sell that house if they decide to move.

This enables the trust to balance potential capital gains enjoyed by the buyer with a desire to protect the affordability of that property for future purchasers.

Although you only own a 50% share, you enjoy the rights and responsibilities associated with owner occupation. You may live in the property for as long as you wish.

When you wish to move, your gain is calculated using a pre-determined re-sale formula. This could be tied to inflation or determined as a fixed return calculated for each year you live in the property.

Who can take up the scheme?

The scheme is not available to everyone. Eligibility is determined by assessable household income. Typically, eligible purchasers would be unable to purchase suitable housing in the open market.

An example of how it works

Jan has been renting for a long time. She and her daughter Hannah live in a small unit. She likes her neighbourhood, and Hannah has just started school in the area.

A big worry for Jan is the uncertainty of renting – she's had to move three times in the last five years. She feels that home ownership, and the stability that it would provide, is out of reach.

Jan has an income of $45,000 per annum and the banks would lend her about $150,000. This would not enable her to buy anything in her area.

Jan is eligible for the *Yourhome* scheme. She takes out a $140,000 loan, which gets her 50% share in a two bedroom unit with a small private garden recently built by the trust.

Five years later, Jan decides to move. Jan's 'equity' in the property is calculated using a formula tied to inflation – let's say 4% per annum. Also, Jan has paid off some of her home loan, so she will have built up a significant amount of equity – perhaps $30-40,000.

The trust then makes the property available to other purchasers. Because Jan's potential profits from the sale are capped, the property remains affordable for future buyers.

2.5.1 Understanding/first reactions

As with *Firsthome*, participants quickly assimilated the broad principles structuring *Yourhome.* The crucial differences with *Yourhome* – that the partner retains a stronger on-going interest and equity shared with a greater emphasis on preserving affordability – were acknowledged and advantages and disadvantages considered. While the scheme was generally well-received, this endorsement was often framed as 'a good idea for others, but not really appropriate to me'.

In many regards, discussions around *Yourhome,* and in subsequent comparisons when the schemes were discussed together, helped tease out the relative priorities and drivers behind wanting to become homeowners for the participants.

Yourhome was seen as beneficial in terms of offering security and stability, and recognised as a viable proposition for lower income households who, realistically, would have limited options to escape the 'rental trap' in the long term. Although owners would not benefit from all equity gains, or indeed a proportionate share of those gains, participants recognised that it would help build assets for those who would otherwise struggle to save.

However for many, it was simply perceived as a better form of renting, rather than a stepping stone towards full ownership. Most felt *Yourhome* was not appropriate to *their* circumstances (although arguably in many instances in terms of income, it was more so than *Firsthome*) because it did not feel like ownership: there was a partner with as much interest as you; and you could not step up towards full ownership. For many, this was the crucial 'deal breaker'.

Having often emphasised that security and stability were the key drivers shaping their desire to become homeowners, the debate stimulated by *Yourhome* teased out thus relative balance between security and asset gain in more detail.

'It looks like an assistance program. It's a step better than renting … Does she own – it's like having a pair of shoes, but you only own one and the other one Myer owns it.'
Petersham, lower income, female

'…Yeah I'll get awfully tired of hopping around for five years. Can we have the other shoe?'
Petersham, lower income, male

'One of the benefits she [the hypothetical customer in the example provided] would be having is the stability of being able to stay there and know that she can stay there. And that depends on what your circumstances are. Just having that might pay out a lot of other things.'
Coburg, moderate income, female

'There's nothing mentioned here in terms of if you want to buy the remaining share from the partner … So if it is not possible, then it's not your house. It's more like renting, but you're getting a proportion of the rent back at the time when you move out.'
Liverpool, lower income, male

'It's obviously hard to buy a house by yourself … instead of just renting … they could put their money into this and come to the end of it, and if they want to settle down with somebody or if they get a better wage and they want to buy their house, they've got some equity and they can sell that, and that's their deposit.'
Sunshine, lower income, male

2.5.2 Price formulas

A core difference of the *Yourhome* model is the detachment (or at least partial detachment) of potential asset gains from housing market trends. This is arguably the most alien and difficult aspect of the consumer proposition. While many immediately understood the mechanics of the scheme, others needed further discussion to clarify how it might work in practice.

With *Yourhome*, the subsidised costs of initial entry are preserved through limiting house price growth and

'This one [Yourhome] is based more on affordability as such, where the sale price of the property is capped in the end so that it can stay in the system and the next person that comes along hasn't got to pay full marketable value for the property and they're getting further assistance as well.'
Carindale, moderate income, male

ensuring that those asset gains are to a large degree retained within the property – with the Trust – to be passed to future purchasers. Instead, any gains on the portion owned by the partner are subject to a pre-agreed, indexed formula, which, alongside gains accrued through the paying off the capital on the owner's share provide an opportunity for wealth accumulation by the household.

Many participants suggested that having gains indexed provided a safe long-term investment, putting money into the property much as you would with a low risk, long-term deposit plan. Although the advantages of such arrangements were understood, those benefits were perceived as appropriate for others – younger people starting out, single parents, long-term renters moving towards retirement – but typically not themselves. Whilst seen as a good idea, it did not provide the control and reward integral to their aspirations.

A number wished to explore the implications of how the price formula would be set, and picked up that the suggested value in the descriptor, increasing in line with CPI, meant that the purchaser might effectively stand still. Certainly if they were paying interest rates double this figure on the share of the property owned, the benefits were considered heavily compromised.

Many participants acknowledged the benefit of preserving affordability for future generations, with a few expressing strong support for what would represent a radical shift in the housing market, and in the concept of home. In a number of the groups, this sparked interesting debate looking at the motivations and the role of such schemes: Are they about facilitating individual opportunities for wealth accumulation, or vehicles for bringing about change to how the market works?

Others were more sceptical as to how a two-track market might work, questioning whether it was feasible for most houses to be following market trends with *Yourhome* properties an 'island', moving to a different beat.

2.5.3 Associations with public housing

Participants' reactionary association of *Yourhome* with public/Commission housing consolidated views that the scheme is a good idea for others. The research sought to tease this issue out in greater detail to determine whether particular terminology used shaped this association. A number of words/concepts raised issues:

'I don't know the formula … but it could end up being – she could end up losing money on having stayed there. Really the only big advantage if she doesn't make money on the situation is the stability.'
Petersham, moderate income, female

'It's like a savings plan, more so than this is actually your house. I mean, some people may need to live in it for the rest of their life, other people it's a step … to move to bigger and better things.'
Sunshine, lower income, female

'It's about a secure investment, which is like how people choose to put money into long-term bank accounts. It might only get 2% interest, but it's stable. You know you're going to get your money back at the end of it … they're basically putting their money into a relatively low-risk thing.'
Sunshine, lower income, female

'It's a bit hard to believe that you can have some houses making huge amounts of money and then just across the road this one's going to sit there at a really affordable price.'
Coburg, lower income, female

'Like somebody would be actually interested in keeping the housing industry … only going up incrementally. It would be so much better. But the problem with this is that we're imagining it an island. Therefore we don't think it will work. Because we're imagining all these other people around us, making money.'
Petersham moderate income, female

'Would it be that you're in a community where everybody's all in the same boat? So then you're getting a community like some of the communities we have now where it's all Housing Commission.'
Coburg, moderate income, female

- ‘Community’ in the context of Community Trust was seen as akin to Commission developments, and raised notions of people using *Yourhome* being clumped together in concentrations and thereby repeating previous mistakes.
- As described, the scheme would be tied to new supply in small developments. Without the freedom to go out and choose their home in the open market, a view that *Yourhome* risked being little more than a new form of public housing was consistently raised. A lack of choice, or more importantly a lack of ability to exercise one’s own choice, was seen as a clear barrier – it ran counter to one of the expressed drivers and goals of ownership.
- With the scheme requiring a smaller equity share to be taken by the buyer (and therefore lower income) and the commensurately greater ongoing interest by the partner, participants felt *Yourhome* was more suitable for those looking for security of tenure.

A number of participants assumed stronger associations between *Yourhome* and government involvement than *Firsthome*, acting to cement ‘assistance program’ and Housing Commission connotations. In drilling down to consider core elements and isolate any specific terminology used, it became apparent that these relatively negative associations were underpinned by key aspects of the scheme’s architecture: namely a lack of choice; being tied to limited properties, in limited locations; and the preclusion of ever owning the property outright.

‘The thing that popped in my head is, are all these houses in the same place, because to me it just sounds like a ministry of housing lot.’
Sunshine, lower income, female

‘It sounds to me like it’s just the government getting people to pay for public housing …It’s more of a government scam than actually trying to help people. They’re trying to offload the cost of providing cheap, affordable housing to low income earners by getting them to pay for it.’
Petersham lower income, male

‘Even though people will be paying off half the mortgage, I think it’ll always have that Housing Commission stigma sort of attached to it.’
Petersham, moderate income, male

‘You’d have to choose what they had. Which goes basically with any public housing, when you come to think of it. You’re given a list, and that’s where you choose from, and that’s basically it.’
Coburg, lower income, female

‘It’s the lack of choice that implies that you wouldn’t do it unless you had to. You would keep an option of more choice. Therefore that more choice would cost you more.’
Petersham, moderate income, female

2.6 Issues relevant across both schemes

2.6.1 Partnership arrangements

Although the nature of the partner was indicated within each of the descriptors (government agency and not-for-profit community trust respectively), the issue was opened up more broadly to discuss preferred arrangements, the role of partners, the implications of having a partner, and what that meant in terms of their aspirations for ownership.

As previously noted, the involvement of another party in the equation was acknowledged and essentially accepted. Many participants reflected that when purchasing a house under normal mortgage arrangements a long-term partnership is entered with the

‘You would really have to define what the partner is and what his responsibilities are. Are they there merely as some sort of government backup so that lower income families can afford to buy a house a chunk at a time? Is that their role?’
Springwood, lower income, male

provider anyway. Crucial to acceptance of partnership arrangements was a sense of fairness in that relationship.

This did not necessarily translate into only identifying with arrangements that maximised gains that would flow to them. Rather, most recognised that the benefits accrued in being able to access ownership sooner than they would have been able to – if at all – had to be balanced by a series of trade-offs that acknowledged the assistance provided and risk taken by the partner.

Sharing a proportion of equity at sale was seen as reasonable, although they were less easy with the partner taking a disproportionate share of any uplift seen. Greater concern was expressed in terms of having to take full responsibility for rates and maintenance while only owning a proportion of the property. In the case of *Firsthome*, the question of fairness also focused on benefits accruing to the partner from any improvements made by the partner. Although the descriptor noted that any value added through improvements would be taken into consideration at valuation, it was felt that this could raise problems.

Most accepted that the partner would be silent, and understood that from purchase to selling on, that arrangement would feel little different to being 'full' homeowners. Some questioned whether it would ultimately feel like their own property, and many searching questions were asked about what would happen if they wanted to knock through walls or put on an extension. Other issues also caused some doubt, for example having to be owner occupiers (what happened if we had to move away for a period through work, would we be allowed to rent it out?), and their long-term rights over the property (Whose name goes on the deed? Can I pass on my equity share to my children?).

The role of the partner at the point of sale and moving was less clear. The arrangements for *Firsthome* and *Yourhome* at sale are different, but in both cases many participants expressed doubts regarding the degree of control the owners would actually have. In the case of *Firsthome*, some felt that the partner would, rightly, seek to ensure that their interests were being protected (would they have a say on whether you could sell in particular market conditions, or prevent you selling if not at their own valuation?).

In terms of whom they would prefer the partner to be, the majority of participants sought the security of government, although it was in performing the role of 'guarantor' and being more trustworthy than other options, as with *Firsthome*, rather than an arrangement

'Don't you have to look at it as what would the other person get out of it as well? It's a win-win situation if you are not ready to put that deposit down and you really want a place to call home, your home, and it's a good start. I think it's a good start.'
Liverpool, moderate income, male

'When you go to sell it, you'll get a bit peed off, knowing that you've spent X amount to get a place at this state and … your silent partner didn't contribute and yet he's getting his 30% profits.'
Liverpool, moderate income, female

'The government changes but it takes a while for the government change to happen and you've got some warning. You don't just get told – like you're gone and that's it. I think with the government you don't feel like you're going to end up losing on the money as much.'
Springwood, moderate income, female

'How would you regulate the other partner if it's not government? That's what I'd be interested to know. But all that should be – if the other party can't force you to sell then you're right, you should just be in a normal resumption position ... yeah I guess I wouldn't have those sort of suspicions I guess.'
Carindale, moderate income, female

'If you buy this as a family home and it goes through twenty generations, does that business still insist on putting in the 30%, or does that particular government in power still exist, have we gone on to a republic, whatever. So for them to get their money, the property has to be sold.'
Coburg, moderate income, male

'They had a similar thing like this down in NSW many years ago before it collapsed – lower income earners in the Department of Housing ... but the whole thing collapsed and died and there were a lot of people left right back where they started from.'
Springwood, moderate income, male

like *Yourhome* that implied a modern take on a Housing Commission development.

Builders and developers were perceived as being at greater risk of going bankrupt and with less responsibility over the long-term. Participants felt that the innovative nature of the schemes required the backing of government, and that pragmatically, government would be obliged to look after all parties' interests and had an interest in ensuring that their involvement was beneficial rather than detrimental. Despite this broad consensus, there was concern about the implications of a change in policy. If the government changed, would the rules also be changed halfway through? Others noted that governments had tried similar schemes in the past that had failed and many people had had their fingers burned.

A number of participants emphasised that valuation – both at the time of entering and exiting shared equity arrangements – needed to be independent of the partner. At the time of initial sale, there was concern that the actual full market value (and thus share) would be inflated. Similarly, at the time of re-sale, the market would need to determine the value.

'I would still be worried about it, because the government had a lending scheme they did about 25 years ago, and I've had a few friends that were on that and got absolutely burnt with it. So I think any government scheme, I'd be very wary.'

Coburg, moderate income, female

'I'd be a bit worried if the people that are investing the other 50% are actually the property people that are building the properties because it's not hard to over-valuate a property, so they're saying its $300,000, so I'm putting in 150, when it's really 220 … then when I go to sell it and I get 280, I'm actually losing money, do you know what I mean?'

Coburg, moderate income, male

'I would be really worried about the day the valuer comes around to determine how the value would be split up. That would bother me.'

Petersham, moderate income, female

2.6.2 Moving on, moving up?

Shared equity schemes have typically focused on helping first time buyers get on the housing ladder, and the product benefits and architecture geared towards mediating barriers at the time of purchase (such as avoiding the need to save up for a large deposit). Although product literature is transparent in explaining the relationship and arrangement buyers enter into, the future resale of re-mortgage of their new home is seen as long distant and uncertain.

For some participants, this longer term trajectory of the partnership was somewhat secondary: such schemes would offer them the opportunity to get their own place, and they would have little intention of moving. In these cases, the details of partnership, and what happened if and when you moved on from the property was not dissected to any great degree.

However for most, being provided with greater certainty regarding how such arrangements would unfold over time and particularly at the time of sale, was crucial. This was true of both *Firsthome* and *Yourhome*. Although recognising that each scheme offered the possibility for asset gains to accrue – especially so in the case of *Firsthome* – there was a significant risk that those gains would not enable them to move on: there was a risk that despite being better off than they would be had they

'The person who actually takes up the loan is … if house prices increase greatly, they're stuck in a low-income: this is your pool and you will never get out of it.'

Coburg, moderate income, female

'You do get left behind, though, if this had been in place 15 years ago, if people wanted to sell and get a new house they wouldn't be able to because of the boom.'

Coburg, moderate income, male

'How are you going to ever get another place, with only the payout you get? I don't see how you'd get ahead unless you wanted to just stay there.'

Coburg, lower income, female

'On paper anything can look good. But the reality is, if your income doesn't go up, all of a sudden this massive expenditure, this part of your dream, the extension of your dream goes up, then do you struggle to maintain that dream?'

Coburg, lower income, female

continued renting, they would be 'trapped' as wider market gains left them behind.

Many participants picked up on the dangers of their incomes not rising as fast as house prices, creating a situation where the proportion of asset accruing was growing, but in absolute terms, stretching ever further away from the level of equity required to enable transition to 'full' ownership.

This was a significant concern for many whose incomes were unlikely to grow substantially, and certainly not at a level that would keep track of housing market trends seen in recent years.

Although recognising that 'nothing is certain', such arrangements represented a series of unresolved, potentially problematic, issues that would need to be addressed down the line, once they were locked in. For a number, this acted as a strong counter to the benefits provided at the time of entering ownership, and indicated that they would rather struggle now than 'pay later'. The costs of ownership were seen as uncertain enough: changeable mortgage payments and responsibility when things go wrong. These shared equity arrangements were seen by some to add a further layer of uncertainty and risk. Others were more pragmatic, suggesting that if a move were necessary, expectations would need to be recast either in terms of location or size. This might be acceptable if, for example, downsizing at retirement, but somewhat harder for a younger, growing family.

'I just think it seems like benefit now and then potential problems later. It would be better to have – you know – build up that deposit or take the first home buyers grants, as it stands at the moment, and have all the problems fixed right now and then know what's going to happen.'

Petersham, moderate income, female

'The best thing to do is probably sell your house off, because if you have 70 per cent of it, it's burned up, stuff paying the extra thirty, just sell it off … go get something else you can afford.'

Sunshine, lower income, male

'I think having a variable … the potential for this house to all of a sudden go up a few hundred thousand dollars in a year, seems unfair.'

Coburg, lower income, female

2.6.3 Who should be eligible for help?

A key characteristic of government-backed shared equity schemes is that they are targeted: eligibility criteria are set, either on income levels with consideration of other liabilities or assets, maximum price limits on the property being purchased, or a combination of both. Crucially, the size of loans provided are determined, and limited, by applying affordability criteria (ensuring that purchasers are not stretched). This creates a fairly well defined window (but one that shifts in different economic and market contexts) in terms of eligible households and properties.

Discussion regarding targeting needs teasing out, not least because through their involvement in the groups, many participants recognised that they were the potential target for such schemes. Furthermore, the descriptors for both schemes provided walk-through examples where indicative incomes and house prices were identified. This inevitably focused participants' attention to those situations. Thus, the extent to which they felt that *Yourhome* was best suited to lower income

'It's $70,000 household income [the example used in the *Firsthome* descriptor]. A lot of people wouldn't be eligible for that. It seems to me like a lot of people paying rent that make a fair bit of money wouldn't fall within [this].'

Coburg, lower income, male

households and single parents such as Jan (the subject of the descriptor) or *Firsthome* more appropriate for working families with moderate incomes, as a result of inference, should be acknowledged. Nevertheless, as participants debated the issues, it was clear that those perceptions were backed up with an understanding of the advantages, disadvantages and different financial obligations and potential of each of the schemes. Although a few participants felt that schemes should be available to anyone, most suggested that they needed to be targeted. In the case of *Firsthome*, participants worked out what the criteria meant in terms of their own circumstances. Reflecting a good understanding of how the products worked, many pointed out that such schemes were likely to be geared more towards those on moderate rather than very low incomes.

Many noted that the income limits indicated were 'not that high' and there were many people earning that much, if not more, who faced significant barriers. Others honed in on the indicative property price ceiling, or the maximum that could be borrowed, suggesting that it would not go very far in their local housing market. A number argued that the criteria would need to take into account different market contexts.

Some participants had previously owned their own home but because of marital or relationship breakdown had fallen back into renting. They stressed that they missed out on government initiatives such as the First Homeowners Grant (FHOG), and made a case that such schemes should not only be available to first time buyers. Others noted the importance of having criteria that also assisted those nearing retirement, or who were already on an aged pension, who were precluded from obtaining a home loan – even for a share of the property – due to their age. A current public housing tenant expressed her predicament where increasing income as she moved towards retirement placed her in a situation where she may soon earn too much to remain eligible, yet not be in a position to buy her own home. Shared equity arrangements were seen as a means of addressing this trap.

The perceived target groups for *Yourhome* were different, with participants tending to associate the scheme with public housing, and with lower income groups who had limited choice. Although in one group it was observed that 'the point is none of us can afford to buy a house', and many participants acknowledged that they were struggling to get on the housing ladder, most felt they would get there with a helping hand, rather than needing something more institutional, and secure over the longer term as suggested by *Yourhome*.

'It shouldn't always be restricted to low income earners. I believe that, because – don't get me wrong – I live alright, but I cannot do this. I need some sort of help. My family are going to help me, if I didn't have family, I'd be rat shit. Something like this, I wouldn't need a fork out from my family.'

Sunshine, lower income, female

'A low income person may not be able to afford the ongoing costs of owning a property because remember in both schemes the ongoing costs are met by the occupier of the property as well. So the low income person may prefer to remain as a renter because at least with your rent you pay your rent and that's it.'

Springwood, lower income, female

'Because I mean nowadays there's a lot of couples that have split up and not made anything off their first sale. But then you're penalised because then you don't get the first home owners grant and then schemes like this, so would you be eligible?'

Petersham, lower income, female

'My concern with this version [Yourhome] is …let's just get rid of the low income earners and put them away in their little pockets and not worry about them. I just don't like that kind of mentality.'

'OK – let's take that away and it doesn't exist. What have they got?'

'Well they have cheap rent in the form of Commission housing. What I'm saying is that paying back a mortgage is probably going to be more expensive than the rents that they're on. And I know someone who's lived in a Commission house for years ... He's had quite a bit of security, and he would not be able to afford this … but he pays less rent, so he has a bit more money to live on. So I just don't know how it's going to benefit a lot of people in that situation.'

Coburg, moderate income, group discussion

2.7 Summary: consumer perspectives and issues

> 'I think, though, people that go for these schemes, they're not going to go into it to make a profit. They're going to go into it to buy a house, for somewhere to live, for stability, for somewhere they're going to stay and they're not going to go in for profit.' (Coburg, moderate income, female)

> 'I suppose with these schemes you do have to rethink what the house actually is. You just have to have a different mindset I suppose.' (Coburg, moderate income, male)

People understood shared equity. They were able to articulate its benefits, recognise its downsides, and accept that you cannot have one without the other. Having to make a trade-off was understood: they were in a position where such a scheme would enable them to get on the housing ladder; without it, they would continue to struggle. In many regards, our participants' reactions and level of interest echoed previous market research undertaken by government agencies in the process of products being developed and rolled out (Colmar Brunton Research Services, 2005; Stamfords, 2007).

We did not seek to try and extrapolate their interest into understanding the potential scale and nature of a shared equity 'market'. Rather, our core concern has been to provide greater depth of understanding in terms of how different shared equity arrangements are received, both in terms of their overall 'pitch' as well as specific elements that make up that pitch. Understanding the consumer proposition is crucial – hence the important focus on this issue in the second stage of work and Final Report. While reiterating that a wide variety of interests and objectives need to come together to make shared equity work – policy, lenders, investors, consumers – if the resulting product offer does not work for the target consumer, then there is no viable product.

By looking at both community and individual equity models, and talking to different income groups aspiring to ownership, the aim was to understand consumer interest across two arrangements that may each help deliver similar policy objectives, but at different points within the continuum of housing strategies. The policy drivers for both models are broadly similar – certainly in the context of a comprehensive affordable housing strategy – however, the consumer understandings draw quite distinct lines between the two.

It is acknowledged that our research participants were recruited on the basis that they expressed interest in wanting to buy a home, and therefore were likely to have established notions of what that meant, defined in terms of being a 'normal' homeowner. This starting point arguably favours the proposition provided by individual equity arrangements. It could be argued that had we structured our sample groups amongst those interested in, for example, possible long-term rented or 'alternative' (however defined) housing options, then those pre-determined views may have been different, and relative levels of interest across the two models couched in different terms. Nevertheless, our insights highlight the importance of getting the proposition right for the consumer is vital – it's not simply a matter of 'good' policy or financial innovation – as is the need to recognise that different arrangements will be considered on different terms.

2.7.1 Summary issues to take forward

For both schemes, consumers understand the principles behind shared equity arrangements

- → Although a complex proposition, the concept of 'sharing equity' can be explained and is picked up with relative ease. Potential difficulty in comprehending the

product ‘offer’, often seen as a limiting factor, is not the barrier it may be perceived to be.

- A number of participants noted that such schemes raised questions about the values they attributed to housing and concepts of home.
- Consumers recognised that the advantages offered by such initiatives are not in the form of a silver bullet – you do not get something for nothing. The key factor here was whether those arrangements and trade-offs involved were seen as fair.
- Foregoing a share of any capital gains was seen as a reasonable trade-off in return for assistance provided by the partner at the time of purchase. Similarly, it was expected that the partner should share in any downside risks.
- Most people felt comfortable with the government being the partner (although the relationship was rather more confused in the context of ‘community equity’ – see below). There was recognition that it was a ‘safe’ option financially, but some concern was expressed regarding risks arising from changing policy priorities.
- Arguably ‘minor’ disadvantages, such as taking 100 per cent responsibility for rates, bills and maintenance despite only being a ‘part owner’, were front of mind and questioned in terms of fairness.
- Participants were rather more pragmatic about what would potentially be greater points of contention over time, such as the changing cost of purchasing further shares in the property (in the case of *Firsthome*), and the sharing of equity at the time of sale.

Unpacking key differences between the ‘individual’ and ‘community’ equity schemes helps highlight drivers shaping ownership aspirations

- Participants consistently sought to balance the two leading facets behind their aspirations for homeownership – a place of one’s own/security on the one hand, as a focus for asset accumulation on the other.
- The inability to save for a deposit, the higher cost of servicing a mortgage, and the uncertainty of those costs, topped the list of issues raised when discussing barriers *prior* to being presented with either scheme for consideration.
- While the benefits provided by both schemes in addressing these issues were acknowledged and welcomed, the role of home as asset became more emphasised when the schemes were discussed: whether the arrangements enabled them to *feel like* homeowners (and therefore enjoy *all* benefits of ownership), was central to interest.

‘Community equity’: a good idea, ‘but not for me’

- The concept of preserving affordability, and therefore constraining the individual equity gains was understood. The model was seen as an effective ‘savings plan’ and good for those looking for long term security.
- A number recognised that the model represented an attempt to address ever-growing affordability constraint, and as such, a challenge to the status quo.
- The involvement of a ‘Trust’ or ‘not-for-profit’; that it was tied to specific units/supply in new development; and targeted towards lower income groups raised associations with social housing. This failed to tap into implicit aspirations tied to being a homeowner, and meant that many respondents felt that this option was not for them.

- Differentiation from the wider housing market reinforced this sense of 'other', and the idea that this was not the housing experience they were seeking to attain through homeownership.

'Individual equity': a stepping stone to outright ownership

- Although it was recognised that they would enjoy most ownership rights even if only 'part owners' with either scheme, for many central to their desire to own was the understanding that it could ultimately be *entirely* theirs down the line.
- Participants recognised that *Firsthome* offered a means of realising 'the dream' and acting as a stepping stone to full ownership. This was crucial in terms of why they wanted to buy. Most believed they would staircase their equity share as soon as possible.
- Being able to select a property on the open market as a normal purchaser, rather than having to be tied to a particular product, was also central to *Firsthome's* appeal. This reflects the importance of choice and the role of home purchase in being able to express this aspiration.
- Again, *Firsthome* was seen as providing greater freedom for owners to treat their homes bought under shared equity arrangements as other homeowners in terms of being able to renovate, enhance, and add value over time.
- However, many expressed potential concerns regarding the ability to step up and move on if the housing market continued to accelerate: it was acknowledged that equity gains would accrue, but with the rest of the housing market rapidly rising, they may be 'trapped'.

Different products: appropriate for different markets, or different policy objectives?

- A principal driver between testing the two models was that they may offer viable options across different market contexts and levels of affordability constraint.
- In policy terms, they can be pitched as variant forms of shared equity, reflecting perhaps different income groups to be assisted, or the degree of subsidy that may be required and therefore considerations as to whether that assistance needs to be retained or recouped in some way.
- However, in consumer terms, they are perceived as quite different propositions. Across both income groups of our aspirant purchasers, it was the product that offered a helping hand, rather than created a distinct product identifying that they were part of an initiative or program, that was key to their interest.
- This places significant importance on the concept of shared equity as a 'stepping stone', pointing towards a transitional rather than a more permanent 'intermediate' tenure. It also points to the importance of ensuring that products and initiatives are structured so that consumers can step up, or move on.

3 SHARED EQUITY LOANS AND HOUSING MARKET CONTEXT

3.1 Introduction

> 'Why has there been such a pronounced shift towards reliance upon markets, or quasi-markets? Broader economic and social forces are influential, but ultimately these changes reflect deliberate policy decisions. This suggests that politicians and the voting public have come to believe that markets or market-style mechanisms work best at delivering what they want to achieve' (Bramley et al, 2004, p. 4)

This chapter considers the complex interplay between housing markets and shared equity arrangements. It is, inevitably, a highly dependent relationship, as is the case with most aspects of housing policy (and, of course, any form of residential lending activity). However we argue below that there are a number of particular aspects to the shared equity-housing market nexus, in terms of shaping the rationale for schemes, the design of products, and the consequent, ongoing interaction of those arrangements within their market contexts, that warrant further attention.

The relations between housing policy objectives and the housing market have always been complex. This has intensified in recent decades as neo-liberal frameworks have come in part to assume, and rely upon, the robust operation of the housing market to underpin the delivery of a range of those objectives. Governments internationally have been somewhat complicit in assumptions tied to 'market-as-solution' in response to 'market-as-problem', and reliant on corresponding measures used in 'market-centred' frameworks (Bramley et al., 2004; Cole, 2007; Cole and Nevin, 2004). These frameworks benefit from rising markets – which have contributed to greater levels of exclusion and reduced affordability for many. To an extent, affordable housing strategies are bound within these assumptions.

Complexity is further compounded by the interplay of both direct and indirect tax and benefit regimes tied to homeownership, as well as broader policy directions in terms of economic and welfare arrangements tied to, and dependent upon, the wealth represented by housing assets (Maxwell and Sodha, 2006; Smith et al., 2008). As seen in many other advanced economies (Smith, 2006), the wealth of Australian households is, in large part, housing wealth, and the proportion that housing-based assets account for in the overall equation has progressively (or rather regressively) stretched disparities between homeowners and non-homeowners in recent years. However, while driving homeownership as a means of building assets has both individual and broader policy benefits, it clearly also introduces individual and systematic risks that tend to be more hidden within debate – certainly until recently (Smith et al., 2008).

Shared equity arrangements straddle this difficult context. At the point of entering into an arrangement to purchase with the assistance of a partner, it can be argued that shared equity is predicated on the fact that house prices have become sufficiently stretched from household income levels to present affordability constraints for particular target groups.

'Individual equity' and 'community equity' schemes' relationship to, and dependency on, housing market context are different, and indeed the different nature of this relationship acts as the key defining characteristic between them. Community equity arrangements seek to preserve affordability over time within the stock where subsidy is originally sunk, rather than seeing that subsidy 'lost' where benefits from asset

gains over time flow to the receiving household. In effect, a distinct sub-market is established, tied to particular supply, in which partner interest is exercised at the time of sale. Although moving to a 'different beat', such arrangements continue to be shaped by, and relate to, the local housing markets within which they sit. Eligibility criteria will be shaped by these prevailing conditions, and while predetermined price indices remove direct links between capital gains and market value, an association remains. Equally important, if owners are to move on, then issues regarding the interface between scheme and market at the time of exit will be central to options available for household mobility within the wider market.

Individual equity arrangements have a more explicit relation to market operation. In 'accepting' market value, they may – perversely – help underpin a mismatch between value and the ability of a significant proportion of households to meet that value. In working within, and accepting, such conditions, shared equity arrangements based upon individual equity gain can be seen as a case of 'if you can't beat them, join them'. Given that the benefits are linked only to that household, they are inevitably short-lived.

Reflecting the prevalent form of schemes operating in Australia, individual equity arrangements provide the focus for discussion in this chapter. The experience of these schemes in understanding and working within their respective markets points to the close, and ongoing, interface required if products are to balance the tensions between focusing on appropriate target groups for assistance and financial viability. It also highlights a parallel tension between meeting policy objectives and responding as 'government' on the one hand, and needing to operate and function as a commercial concern and fully face the market on the other. Our focus on individual equity schemes does not obviate a continued interest in community equity arrangements. Indeed, one of the key drivers for incorporating these models within the research framework was a view that the prevailing individual equity models in place in WA, SA and NT would struggle in the highly constrained housing markets of the eastern states, where high prices would necessitate either high income maxima or be modelled on the partner retaining a higher proportion of equity.

The housing market/shared equity interface is first explored in terms of issues tied to shaping the product to enable households to access homeownership (Section 3.2, 'Getting in'). This considers how eligibility criteria for schemes are determined in the context of particular market conditions; how schemes respond to market dynamics over time; and what impacts different spatial market contexts – between states, within cities – have on shared equity design and feasibility. Secondly, the ongoing relationship between schemes, market dynamics and consumer behaviour is considered (Section 3.3, 'An ongoing relationship'). This recognises that market dynamics also determine the ongoing appeal or otherwise of shared equity once those arrangements have been entered into. A hypothetical market cycle is presented, and issues for lenders, consumers and policy-makers at different stages of that cycle considered.

The impact that private-sector led shared equity schemes may have on the market is not explored in depth in this chapter. The scale of take up of these arrangements since the launch of Rismark-Bendigo and Adelaide bank's Equity Finance Mortgage (EFM) in 2007 is unclear, but given current financial contexts (see Chapter 4), is likely to remain on a fairly small scale. Given EFM's broader focus, where the product is not simply being targeted towards households of policy interest but rather seeks to capture expected growth in mid- to high- value property markets, potential concerns regarding additional demand-side pressures arise if such schemes were to be encouraged on a much larger scale.

3.2 Getting in: target groups and scheme viability

3.2.1 Meeting the market: targeting and eligibility issues

Government-backed shared equity arrangements are targeted towards lower and moderate income households. The interface between scheme design and market context represents one of the more complex challenges faced, both in terms of viability, but also in terms of how policy interest is defined and justified. Shared equity policy frameworks cannot be driven by assisting those in most housing need in the traditional sense. Although the subsidy over the long term might be relatively small, or indeed recouped with a beneficial gain to the subsidising authority as equity shares are bought out or the property sold, concerns regarding 'middle class welfare' and vertical equity come into play here.

Those entering into such arrangements clearly need to have, and be able to sustain, a reasonable level of assured, long-term financial capacity. In order to work in the current market context, shared equity initiatives are typically geared towards those with incomes below, but *not significantly below,* median incomes, and enable purchase of properties in the lower quartile to median price range. Schemes therefore become geared towards providing a 'helping hand' for those unlikely to be eligible for other forms of assistance.

Australian state/territory shared equity initiatives have adopted broadly consistent eligibility criteria to achieve a targeted approach. Most are based upon a range of parameters – maximum household income, maximum property value and maximum proportion of equity share that can be held by another partner – which together tightly bound their potential reach.

A number of initiatives are specifically tied to the prevailing tenure of prospective customers, such as HomeStart's EquityStart and Keystart's Goodstart, assisting social housing tenants to purchase their homes or move out of those homes and purchase in the open market. However, all are dictated by a strict adherence to ensuring both initial and ongoing affordability: maximum loan amounts are determined by ensuring that borrowers can comfortably service the loan, typically between 25 and 30 per cent of total gross household income. Indeed, one of the largest schemes, HomeStart's Breakthrough loan, uses this as the principal factor and is less explicit in terms of setting parameters for maximum income or property values.

Table 5 presents an overview of the current eligibility criteria for state/territory schemes. Most have already seen iterations to these criteria (as discussed in the next section). Although these criteria are stated in terms of maxima, the strong market context of recent years coupled with higher interest rates until the latter half of 2008 has ensured that product viability has been fairly tightly defined by those levels. All also include a number of further considerations as part of assessment, including household structure (with income limits varying between single purchasers and households with children), the value of other assets held, and ability to provide the minimum deposit.

Table 5: Eligibility criteria for state/territory schemes, 2009

	Max. equity 'grant'	*Max. household income*	*Max. property value*
Western Australia: ***First Start***	25%	Sliding scale up to $70,000	$355,000 in metro areas
Northern Territory: ***HOMESTART NT***	30%	Up to $105,000 plus asset limit	Regional variation, max. of $420,000 in Darwin
South Australia: ***Breakthrough***	35%	Not set	Not set
Tasmania: ***HomeShare***	25%	Up to $95,316 plus asset limit	Determined by 25% held by Housing Tasmania being no more than $50,000
Victoria: ***Ownhome***	25%	Up to $66,000	Tied to product
Queensland: ***Pathways***	40%	No income/property value limits: restricted to tenants purchasing the home they're renting	

Source: State/territory housing, Burbank, HomeStart and Keystart websites

3.2.2 Responding to market dynamics

Flexibility is important to the success or otherwise of a scheme shaped by addressing the gap between income levels and price values. Despite the relatively short timeframe since their introduction, most schemes' eligibility criteria have been subject to revision. This may reflect changing market conditions, particularly in response to strong house price growth, although criteria may also be reviewed as a means of shaping the potential take-up of a scheme through loosening or tightening parameters according to the extent of funding available. However, such flexibility introduces its own risks, and demands continued consideration between market and policy goals. There is a risk that in opening out the criteria too extensively, schemes will become oversubscribed and too loosely targeted. Similarly, if eligibility criteria do not move in line with the market, there is a risk that the products simply become unviable and out of step with the gap between incomes and values that they are intended to address.

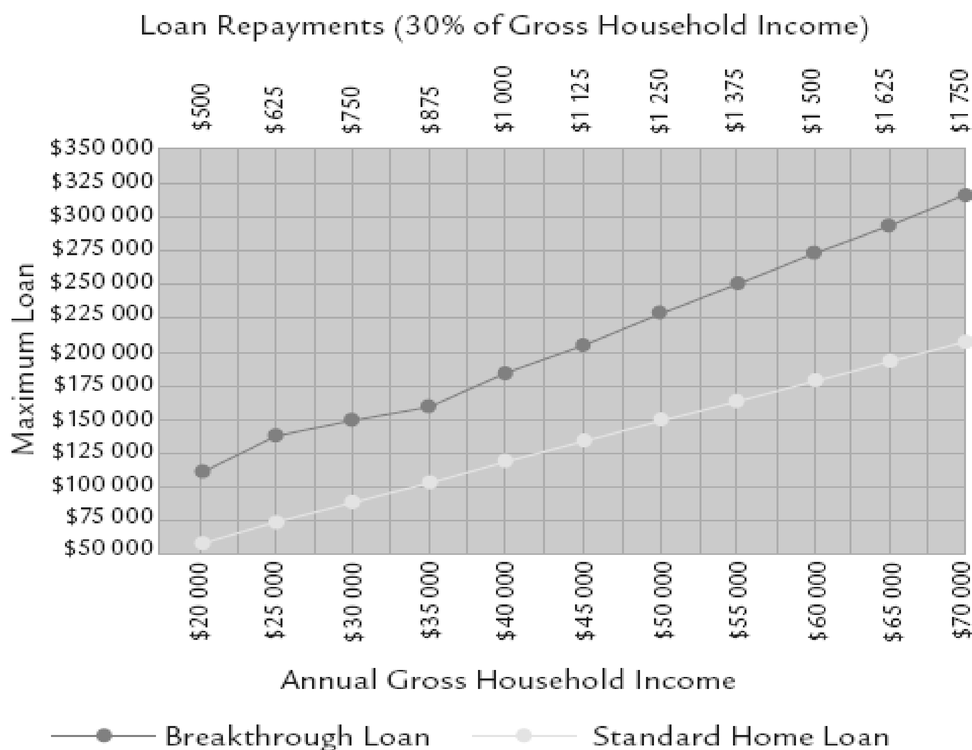
The profile of the customer base for shared equity schemes will also shift in response to housing market cycles, and the extent to which eligibility criteria can, or should, respond to these variations raises a number of questions. As was highlighted in the Positioning Paper, the 'typical' customer of different schemes will not only reflect variations in criteria used and policy objectives, but also the market contexts in which these schemes have evolved and within which they have subsequently operated.

- In 2006, the customer profile of the Northern Territory's HomeNorth scheme, established prior to surging house prices in recent years, exhibited a high number of single-person households and, in particular ,single female-headed households.
- By contrast, approvals for initial applicants for Keystart's First Start product (to early 2008), at a time when the Perth market was continuing to see prices rise, were given predominantly to family households with children (around 77 per cent), with just 23 per cent going to couples and singles (Byrde/Keystart, 2008).
- Where schemes have been in operation long enough to experience the ups and downs of the market cycle, the evident shifts in customer interest, take-up, and

feasibility highlights the challenges faced in ensuring that criteria used translate into the form of targeting desired over the long term. A review of Welsh 'Homebuy' purchasers between 1995 and 2005 saw a substantial shift from assisting lower paid single people and parent households in the early years of the scheme to supporting dual earner households (Welsh Assembly Government Department for Social Justice and Regeneration, 2006).

In large part, principles of responsiveness that enable products to evolve and remain viable, are a continuation of a key driver behind the introduction of shared equity itself. As house prices continued to increase strongly, the traditional product portfolio of government-backed agencies became increasingly unviable. Even with support in terms of low deposit arrangements, reduced equity stakes, and competitive loan rates, the maximum property values that could be purchased through these products became increasingly detached from the market itself. Figure 4 indicates the additional borrowing capacity provided by the Breakthrough loan while still conforming to HomeStart's affordability criteria (no more than 30 per cent of gross household income going towards home loan repayments). With up to 35 per cent equity retained, Breakthrough enables borrowing capacity to be increased by around 50 per cent.

Figure 4: Borrowing capacity, HomeStart's Breakthrough Loan



Source: HomeStart Annual Review, 2007-08, p. 14

Thus, a household income of $60,000 would be constrained to around $180,000 under standard loan arrangements – offering few opportunities in the current market context – but could be extended to a 65 per cent share in a $270,000 loan, increasing the size of market accessible to customers.

Since introducing shared equity schemes, HomeStart, KeyStart and HOMESTART NT have seen a significant shift in the breakdown of product demand across their portfolios. Demand has receded for 'standard' home loans and shared equity products have built up to represent a significant proportion within the overall portfolio. As reported in their 2007-08 Annual Review, HomeStart's Breakthrough loan 'garnered

immediate interest and over the past twelve months has become the fastest growing portion of [their] loan portfolio' (HomeStart Finance, 2008, p.14). This will, to a certain extent, reflect availability of a new option for customers, but it is also indicative of a shift in product preference out of necessity.

Transitions seen in the loan product portfolio are one response to increased housing affordability constraint faced in those markets. However, as house price trends have continued upward (at least until recently), there is a risk that the solution itself becomes undermined by the same drivers. Even where greater purchasing power is provided, the continued stretch between household income and market growth means that the shared equity arrangements may quickly face similar viability constraints.

Criteria too tight in NT, too loose in WA?

In this context, the product will struggle: there is little point in an initiative with income or price maxima that cannot match market availability. Flexibility can provide a degree of responsiveness to these dynamics, however in seeking to keep track of the market, there is a risk of tail-chasing, consigned to a position of following trends (and at worst, in localised contexts, exacerbating upward price movements), rather than relieving affordability pressures[6].

In recent years house price growth in the Northern Territory has limited the potential reach, and thus take-up, of HomeNorth's Xtra product. After a successful re-launch in 2004, subsequent house price gains have created a gap between market context and the amount that can be affordably borrowed by prospective customers meeting eligibility criteria conditions. The shift in income and market value eligibility conditions between reporting in the Positioning Paper (early 2008) and now (May 2009) is instructive: maximum household incomes have increased from $71,000 to $105,000, and maximum property values from $310,000 to $420,000 in Darwin's northern suburbs and Palmerston.

Market context can also work to overwhelm shared equity arrangements, highlighting further the relatively narrow parameters within which products need to be positioned if a successful proposition is not to be a victim of that success. KeyStart's First Start product was launched in early 2007, with the aim of writing up to 1000 shared equity loans a year, and 3000 in total to 2010. $300m was set aside to underpin funding for the scheme. At the time of its launch, the Perth housing market was moving towards the end of a spectacular boom, which had seen median house prices almost double since 2003 (see Figure 5).

The eligibility criteria established helped to ensure that the scheme was both appealing and viable, with its potential reach increased through enabling households with children to take out a 60 per cent share (with Keystart retaining a 40 per cent share). Other favourable factors can be noted. Firstly an effective awareness campaign, helped to drive interest. Secondly, the housing industry responded through new product development. The level of commitment indicated through the scale of finance on offer, as well as wider affordable housing initiatives in train, has helped the government to promote innovation in the market, including development packages that meet First Start eligibility criteria.

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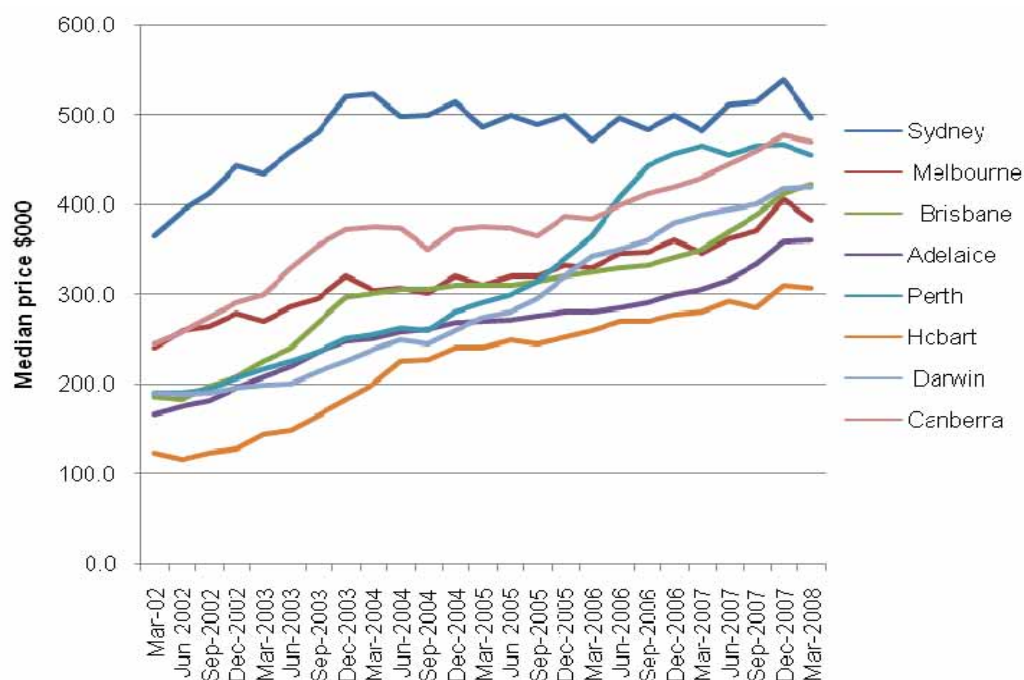
[6] Evidence and policy concern regarding potential risks of stimulating the housing market are considered in detail in the Positioning Paper (Pinnegar et al., 2008). Risks have been identified (Berry, 2003; House of Commons Committee of Public Accounts, 2007) although countered in the UK context by the Shared Equity Task Force (DCLG, 2006) and scheme evaluations (Bramley and Morgan, 2007; Department of Social Justice and Regeneration, 2006)

Figure 5: Median house prices, established homes, 2002-2008



Source: www.abs.gov.au/Ausstats/abs@.nsf/mf/6416.0

Joint Venture Arrangements, between the Department of Housing and Works (within which Keystart loans are based) and a number of builders have been used to produce affordable house-and-land packages available to First Start customers in Ellenbrook and Dalyellup (www.news.com.au, 2008). Builders have also responded outside such arrangements, tailoring products to fall within the maximum price limits, and a number of homeowner websites, such as HomebuyersCentre (www.homebuyers.com) and NewhomeWA (www.newhomewa.com) have given strong prominence to First Start as an affordable financing option for the house packages on offer.

However by late 2008, the brakes were applied as the initial tranche of funding ran out, just halfway through the three-year program; 2500 applicants had gained approval in the first 18 months, and a further 450 fell into abeyance. A statement released by the Department commented that 'the scheme was unsustainable in [its original] form and it was necessary to adjust the settings if we were to reinstitute it in a way that would help as many low income applicants as possible right through to June 30 [2009]' (Department of Housing and Works, 2008b). Allocation of a further $70m funds has been predicated on amending eligibility criteria to ensure the 'most needy' first time buyers continued to be helped. Income caps and maximum property values eligible for the scheme have been reduced, alongside a reduction of equity that the government holds, from a maximum of 40 to 25 per cent. Collectively, these changes are likely to narrow eligibility but also viability of the First Start product.

3.2.3 Targeting and availability: the capacity of shared equity frameworks to provide affordable access in stretched markets

As discussed above, the introduction of shared equity schemes in SA, WA and NT through their respective government-backed arrangements has provided a framework for product portfolios to evolve and keep the market within reach for a cohort of lower to moderate income households. A commitment to maintaining a certain level of access as those markets shift points towards a number of further considerations in understanding the relationship between policy, provision and market context.

The first is the ongoing complexity of housing market operation, with movement within and responsiveness of those markets commensurately difficult to assume simply by translating macro-level trends. Although strong price increases have been shared across Australia since the late 1990s, the trajectories of individual cities and regions have been quite different: Sydney's housing market has been, at the metropolitan level, fairly moribund since peaking in 2003/04, while prices nearly doubled in Perth during this time before peaking in 2007/08.

The state/territory based spatial remit of schemes enables products to be responsive to different income and house price characteristics. Further differentiation given market context is also seen within schemes. WA's First Start has different house price maxima for Metro- and non-Metro areas, while HOMESTART NT's value limits (see table 6) reflect the dramatic variation in housing market conditions across the territory.

Table 6: HomeNorth Xtra market value limits, as at May 2009

Region	*Maximum market value*
Darwin/Northern Suburbs	$420,000
Palmerston/Rural	$420,000
Katherine	$267,000
Tennant Creek	$120,000
Alice Springs	$300,000

Source: DHLG website

Shared equity potential: availability analysis for Sydney, 2001-2006

A second consideration is the question of availability of 'affordable' properties for first time buyers that come onto the market, and how targeting and eligibility criteria reflect, and are appropriate to, those market conditions. The following analysis looks at the Sydney metropolitan area, a city where shared equity arrangements have not been available on any scale to date.[7] Sydney was selected given availability of data, and is used here to explore the parameters within which a hypothetical initiative would have needed to operate between 2001 and 2006. The analysis also illustrates a need for targeting considerations to not only incorporate the relationship between incomes and availability, but in understanding the subregional nature of market operation tied to different income profiles, for a more spatially nuanced analysis at the city scale. The spatial variation within Sydney can be seen as illustrative of the spatial variation between the various capitals and regions.

Our availability analysis focuses upon an indicative first time purchaser cohort, drawn from the 2001 and 2006 ABS Census and defined as a young family (a couple aged under 35 with one dependent child)[8] earning a household income equivalent of the local 40th percentile.[9] Income variability across similar purchaser cohorts has been used as a means of unpacking the impact of the differential growth in household incomes over the period (see Table 7). NSW Valuer General's data for properties sold within a six-month timeframe either side of the 2001 and 2006 Census points were then geocoded to Statistical Sub-division (SSD) geographies.

[7] NSW/Landcom had a small pilot initiative involving the sale of 13 properties in 2003 (Landcom, 2003). Rismark-Adelaide Bank's EFM product has also been available in Sydney since its launch in 2007.

[8] This definition is somewhat 'tighter' than the eligibility criteria used, although arguably reflective of the key household type/income profile of those taking up schemes in WA.

[9] The local income is derived at the Statistical Sub-division level and is based on specially commissioned ABS Census tables.

Table 7: Household income growth between 2001 and 2006 for indicative young couple cohort, selected Sydney SSDs

Region	*Weekly HH Income 2001*	*Weekly HH Income 2006*	*5 Year Change*
Inner Sydney	$1327	$1832	27.6%
Eastern Suburbs	$1601	$2143	25.3%
Lower Northern Sydney	$1648	$2226	26.0%
St George-Sutherland	$1289	$1561	17.4%
Outer Western Sydney	$1128	$1389	18.8%
Blacktown	$1100	$1317	16.5%
Canterbury-Bankstown	$912	$1055	13.6%
Fairfield-Liverpool	$972	$1131	14.1%
Central Western Sydney	$988	$1134	12.9%
Sydney	$1165	$1418	17.8%
Consumer Price Index (CPI)			14.7%

Source: Based on Tice, A. (2008), analysis using ABS 2001 and 2006 Census.

While household incomes for our young purchaser cohort grew by 17.8 per cent, considerable variation was seen across the city, from just 12.9 per cent in Central Western Sydney SSD, to 27.6 per cent in Inner Sydney SSD. Given that CPI grew by 14.7 per cent over the same period, many households in a number of the lower and moderate income markets – Canterbury-Bankstown and Fairfield-Liverpool – saw their household income *decrease* in real terms.

The analysis assumes that our young purchaser cohort buys within their respective subregions (SSDs). The threshold levels used for the assessment of affordability have been calculated using standard criteria.[10] Table 8 presents the percentage loss of 'available' sales to this group between 2001 and 2006 across three geographies, determined as low, medium or high income growth depending on performance relative to CPI over that period. Affordability constraints hit hardest in medium and especially low income growth locations, where escalating house prices became wholly detached from local income growth.

Table 8: Percentage change in available properties between 2001 and 2006

Income geography	*% change in available sales*
Low Income Growth Locations (<CPI growth)	-73%
Medium Income Growth Locations (CPI to 20% growth)	-40%
High Income Growth Locations (> 20% growth)	-15%

Source: Based on Tice, A. (2008), analysis using ABS 2001 and 2006 Census and NSW VG data.

Table 9 (below) illustrates this reduced availability in terms of the broad correction in prices needed for our cohort to regain the purchasing power they had back in 2001

[10] The following assumptions of an 'affordable' or sustainable purchase: A loan calculated using the prevailing Standard Variable Rate in 2001 and 2006 respectively (derived from the RBA); A full repayment mortgage operating over a 30-year life; The loan was for 90% of the property value (so assuming a 10% deposit was in place); The resulting value is affordable if the monthly repayment is less than 30% of the household income.

(based on 2006 values)[11] for localised lower quartile and median sales value in that period. This is an indicative assessment of the level that a shared equity product would need to function at in order to maintain the level of availability in lower quartile to median markets between 2001 and 2006.

Table 9: Indicative corrections required in 2006 lower quartile and median house prices to regain levels of "purchasability" seen in 2001

Location	*$ required change in LQ price*	*$ value of LQ sale*	*As %*	*$ required change in median price*	*$ value of median sale*	*As %*
Low Income	-$90,000	$300,000	-30%	-$140,000	$370,000	-38%
Medium Income	-$67,000	$338,000	-20%	-$116,000	$430,000	-27%
High Income	-$11,000	$383,000	-3%	-$45,000	$500,000	-9%
Sydney	-$84,000	$320,000	-26%	-$120,000	$410,000	-29%

Source: Based on Tice, A. (2008), analysis using ABS 2001 and 2006 Census and NSW VG data.

The analysis gives rise to the following observations:

- At the metropolitan level, a shared equity scheme with the partner retaining up to a 30 per cent share would appear to be broadly in-line with the required amount of support for access levels to be maintained.
- However, spatially differentiated analysis highlights the variability across different submarkets. A broad range on localised lower quartile (variance of $83,000) and median sales (variance of $130,000) between high and low income areas is seen.
- The broad disjuncture between house price and local income growth has placed pressure across the Sydney market, but this pressure has been predominantly focused in low and to a certain extent medium income areas.
- In this regard, a 30 per cent equity share product would have struggled to maintain 2001 levels of 'purchase power' in low and medium income markets by 2006, and potentially risked exacerbating take up of lower quartile properties in higher value markets.

Although this analysis cannot access the potential success, or otherwise, of shared equity arrangements had such a scheme been in place in Sydney during this period, it highlights the challenge of developing a suitably targeted approach. In terms of a scheme being viable in low and medium income areas, it points towards the need for a product mix targeting moderate income groups, or the need for a greater equity share (greater than 30 per cent) to be retained by the partner. As a result, although a First Start or Breakthrough type product may be feasible, it would arguably have been highly stretched (increasing risk and market exposure of the partner; making staircasing a greater task for the owner) over this period, or require income levels that precluded much of the first time purchaser cohort.

[11] This is an *indicative* assessment of the disjuncture between local house prices and incomes, and cannot directly compare the range/quality of properties available at this time points, or what our young couple cohort might *choose* to purchase.

3.3 An ongoing relationship: market dynamics and shared equity arrangements over time

The above discussion has considered the crucial interplay between housing market context and how shared equity schemes can 'work' in terms of enabling a targeted approach towards particular groups, but also being viable and sustainable in terms of prevailing, and changing, market values. *However, shared equity arrangements do not start and end at the point of purchase*. A longer-term ongoing relationship is entered into. Working 'within' the housing market, the effectiveness of shared equity frameworks and product design will be tested throughout this cycle. Although considerations of costs/benefits should be grounded in long-term views, market movements do impact on decisions that have to be made, with many important post-purchase factors coming into play often in a much shorter time span.

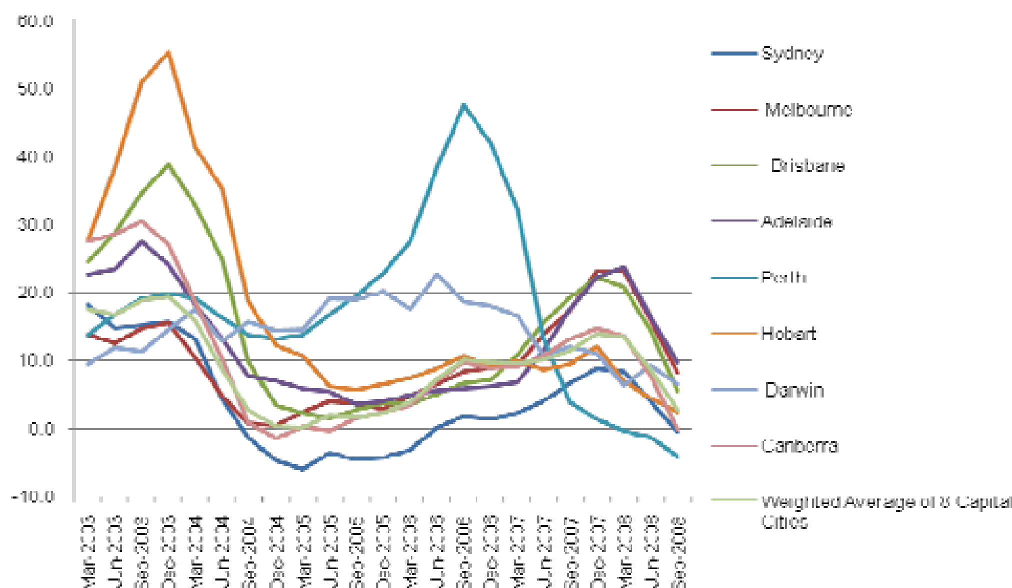
- Households are likely to move a number of times before being able (if at all) to purchase a home outright. Circumstances and aspirations change, and owners need to be able to respond. Their debt needs to move around with them.
- 'Standard' loan borrowers often seek advantage by remortgaging, either with their existing lender or refinancing with another provider. While the full term of a loan may stretch out over 25-30 years, the mortgage may be moved more frequently.

A number of questions arise in this regard: How do market trends impact in terms of ability to staircase, ability to refinance, and move into the 'full' ownership market?

3.3.1 Stepping up, moving on

Policy support for shared equity is in large part predicated on the assumed benefits of homeownership and its value in facilitating asset-generation for those households, providing a basis to access 'full homeownership' sustainably in time. Thus equity gains are desirable, but too greater gains can – as discussed both by existing customers spoken to in the first stage of this project and potential consumers in the focus groups – risk stretching access to the equity share not yet owned. While an ideal scenario aligns to steady growth, the housing market in most developed countries – and reflected in price patterns in Australia's eight capital cities – over the past five to ten years has not performed as such (see Figure 6).

Figure 6: Established house price percentage change from corresponding quarter of previous year, 8 capital cities



Source: ABS Hwww.abs.gov.au/Ausstats/abs@.nsf/mf/6416.0H

In a study undertaken for the Joseph Rowntree Foundation, Alison Wallace has looked at mobility among shared ownership customers in the UK (Wallace, 2008a; 2008b). Although there are a number of important differences when compared to current Australian individual equity models – shared ownership arrangements typically see a lower equity share being taken out at the time of purchase (perhaps 40-50 per cent shared compared to 70-80 per cent and therefore the 'distance' to full ownership is greater), and there is the complication at the time of sale of housing association involvement – a number of her observations are instructive.

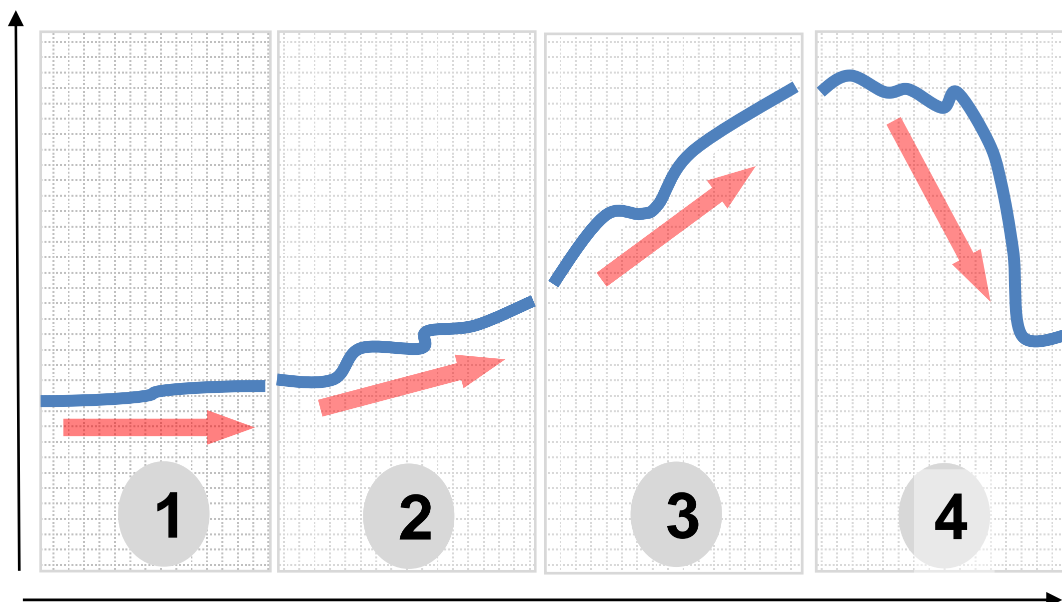
While most shared owners in Wallace's study had made a profit on their share of their home as markets rose strongly, this did not necessarily provide them with a means of moving up the ladder as the 'step up' property with those markets had also risen and moved further out of reach since their first purchase. Many participants were also unable to staircase as rising market values meant that they were unable to purchase additional shares. Within her sample, of those that had moved, only half moved into full homeownership (others 'falling back' into the private and social rented sector), and a third of owners surveyed indicated that they wanted to move, but had been unable to do so due to affordability constraints faced (Wallace, 2008a).

Such observations point to the challenges for policy settings, in working with the market, to ensure that they provide sufficient scope and incentive for stepping up. Again, this is likely to tighten parameters in terms of target markets, pointing towards those who can afford to take out a large proportion of equity at the outset (70 to 80%) and who have income trajectories that stand a chance of at least keeping in touch with rising housing prices.

3.3.2 Shared equity through a hypothetical market cycle

In summarising key considerations arising in the interface between shared equity and market dynamics, a hypothetical market cycle – from relatively benign conditions, through periods of sustainable growth feeding into boom and then to subsequent market collapse – is considered below (Figure 7). In each of the four sectors, many of the issues faced in shared equity arrangements will reflect those faced by those with full, standard loans. However, there will also be distinctive impacts working on the parameters in which products and schemes operate.

Figure 7: A hypothetical 4-stage housing market cycle



1

A flat market

- The housing market remains ‘flat’ with price gains little different to CPI over a number of years.
- This may provide a mix of signals: shared equity customers on steady incomes may purchase additional shares, benefitting from the fact that the cost of those shares has not risen significantly. Others may avoid purchasing additional shares (even if manageable) on the basis that housing investment may appear not particularly attractive.
- There may be limited incentive to maintain and invest in the property, risking the value of the partner’s as much as the owner’s share in the property.
- Given the initial deposit levels offered by shared equity products, it may take a long time for the owner’s equity to build through capital growth.
- However, customers will also have the option of paying down on their interest accruing debt. As such, these conditions could indeed be conducive to achieving equity growth through means other than buying out the lender’s equity share.

2

Steady rises in house price growth

- House prices grow a steady 4-5 per cent, tracking above but broadly in line with CPI and income increases.
- Value of the part not owned increases proportionately, but remains ‘within reach’ where income increases keep pace.
- The owner is assured about the continued strength of the market, and may ‘step up’ equity shares.
- Given steady growth, within 4-5 years, the proportion of equity held by the owner of the market value is 20 per cent - shared equity arrangements have provided a means of getting a substantial deposit together.
- Depending on income growth (because loan repayments will also become greater) the owner is able to redeem the shared equity product and take out a ‘full’ mainstream home loan or upgrade by utilising another shared equity loan facility.
- The partner has gained some benefit through the equity gains on their share at the time of redemption (enough to cover the subsidised interest on that amount for the period of the loan, but probably not a substantive profit).
- Arguably, ideal conditions for shared equity for all – the purchaser, partner and funding arrangements alike.

3

A housing market boom

- House prices increase significantly faster than average income levels. After just a few years, the market value of the property has grown strongly.
- Purchasing additional equity shares, or the ability to transfer to remortgage will be constrained unless income growth has been similarly robust.
- The purchaser may be trapped. The purchaser may not be in a position to qualify for a ‘full’ home loan against the increased market value of the home. The only way to realise their share of equity gains would be for the property to be sold and for them to put those funds against a property of less value or to re-purchase under another shared equity loan facility

- Demand for shared equity products is likely to be at its height – house price growth increasingly pricing out moderate income buyers, and the long cycle of growth stimulates desire not to be 'left behind'.
- However, as the market booms towards its likely peak, scheme providers will be aware of the risks involved in entering the market at this stage. Schemes might be reigned in to avoid over-exposure.

4

A declining, falling market

- Property values have fallen relative to the original purchase cost. The equity value of proportions owned by both owner and partner has decreased respectively.
- Additional shares become cheaper for the owner, but point to a 'loss' for the partner if the owner decides/is allowed to staircase at this time.
- If interest rates fall, loan repayment savings coupled with reduced equity purchase costs, could make staircasing particularly attractive at this time. It may be equally attractive/prudent for the borrower to reduce their interest bearing debt instead of/as well as buying extra shares
- However, in a climate of falling prices, the owner may be reluctant to purchase additional shares; if that additional share involves remortgaging, the lender may be reluctant to lend.
- Owners may become trapped in negative equity, and face problems that all owners falling into negative equity face. However, those losses are mitigated to a certain extent by being shared proportionally with the partner.
- Affordability will start to improve provided that incomes hold up. If prices decline significantly, then arguably the need (and demand) for shared equity schemes will be reduced, and demand for the products may recede.

Although shared equity arrangements do introduce specific considerations, the risks of becoming 'trapped' are arguably predominantly tied to trajectories of household income growth rather than product design. Indeed, given the 'split' nature of their loans, shared equity customers have greater flexibility in terms of how they can increase their portion of equity. They can do so by either paying down their principal balance on the interest bearing portion of their debt loan or, acquiring a greater share of the property by staircasing and buying additional shares from the equity partner.

Recession

Economic recession does not necessarily lead to house price collapse (Joye, 2008), although the shift from credit tightening towards full recession throughout the world in the current downturn has seen significant price falls: in the order of 15 to 20 per cent in both the US and UK in 2008 and continuing in 2009. House prices in Australia had softened in the last two quarters of 2008 (ABS, 2009), although whether the significant declines experienced in other countries will transpose here remains to be seen.

Crucial will be the extent to which unemployment rises: where job losses mount, vulnerability to foreclosure substantially increases. Although marginal owners are typically considered to be at greater risk of unemployment due to vulnerability in lower-paid sectors and opportunities for part-time work and overtime falling back, the current downturn appears to be less discretionary, with jobs being lost across the spectrum. Among current shared equity customers in Australia, latest default figures

show resilience (at what is likely to turn out to be the early stages of recession)[12]. In part, the responsible application of affordability criteria at the outset alongside ongoing support helps to ensure that marginal groups are no more vulnerable as a result of being shared equity customers. While those arrangements cannot shield customers from the difficulties potentially faced by all homeowners in a market and economic downturn, shared equity can be seen to offer a more effective safety net in such situations. Involvement of a partner provides a framework where support can be provided, for example in offering a payment holiday, extending the loan, or buying back an equity share (reverse staircasing).

3.4 Summary

Reflecting the dominant 'individual equity' models currently in place in Australia, this chapter has focused on how schemes enabling purchase in the existing (as well as new build) market (i.e. not explicitly tied to new affordable housing provision) 'meet' and perform across different market conditions. These products aim to provide support as a stepping stone to full ownership, and therefore need to enable those transitions to be made. They need to be able to ensure that staircasing is viable, deal with the fact that people move, and that housing markets rise and fall and indeed that borrowers may go into negative equity. They also need – in terms of supporting policy justification – to balance a tightrope in terms of how criteria are set.

Such issues are arguably less of a concern for 'community equity' models, where the housing purchased under such arrangements sits 'outside' the market. However, this apparent disjuncture from the wider market is arguably as much of a concern in the longer term. Unless purchasers stay put, they will be seeking to enter that market. Households will have built up some equity; however, if the market has leapt forward, then there is the risk that they will be trapped.

Current government-backed initiatives have operated with a close connection to the markets within which they lend. Clearly that is central to all lenders' activities, but it is argued that this interface raises a number of particular issues in the context of shared equity. Such arrangements cannot subscribe to a 'one-size-fits-all' and must be able to respond to the context and dynamics of those regional markets. This close connectivity also ensures that the necessary balance between policy goals and social sustainability on the one hand and commercial viability on the other is enabled. What all this suggests is that shared equity programs should be actively managed and that there should be an ongoing relationship with the borrower.

3.4.1 Summary issues to take forward

Understanding, and working with the market – both at the time of entry and over the life of the loan – is key to product appeal and viability

- → Interest and demand for shared equity varies, and the profile of client groups varies, across the market cycle. Demand tends to increase towards the peak of the market cycle. At this time, risks are higher for all parties involved – certainly if market growth is followed by a downturn.
- → Initiatives need to be able to closely read and respond to the housing markets in which they operate. Initiatives need to have an ongoing focus on affordability and frameworks to respond to shifting conditions.

[12] Risks of exposure are likely to be relatively low, and organisations will have a very clear picture of the typical amount of equity held within each property and any risk of negative equity in the short term.

- Shared equity works well in markets enjoying steady, sustainable growth. These conditions help build equity, help households keep sight of stepping up, and are likely to build greater predictability into redemption profiles.

The design of initiatives needs to reflect the spatial differentiation seen across housing markets and submarkets, between and within cities

- State/territory government-backed schemes benefit from an embedded, close understanding of local market context and the wider housing system and housing policy arrangements within which they operate. Eligibility criteria will – and should – vary in response to regional affordability considerations.
- High value markets, with significant gaps between income and house prices, will find it difficult to make 'individual equity' schemes work. In the context of the focus groups' discussions in Sydney, Melbourne and Brisbane of Firsthome (based on WA's First Start income and maximum house price criteria) participants generally observed that 'you wouldn't get much for that' (although WA's house prices now compete with those in the eastern states).
- In meeting the higher values of housing markets on the east coast at the current time, there is a risk that in order to make the product work, income limits would have to stretch to moderate income levels, or the proportion of equity held by the partner would need to be significantly increased.

Being effective in the market requires being able to operate effectively as a commercial concern

- Products have got to work if they are to be taken up. Arrangements need to work with a careful balance between policy aims and enabling those arrangements to be viable in the market contexts within which they are required to operate.
- Government-backed arrangements have social goals and lending practices that aim to be encompassing rather than restrictive. However, operating within the market they also need to retain their commercial imperative. There is a need for these organisations to have sufficient control and capacity to respond, for example, if the market is overheating or their portfolio is overexposed in particular markets. Buy back options should be in place so that there is always an exit position in place.

Current schemes do not operate on a sufficient scale to adversely stimulate demand in the housing market at a broader level.

- The level of interest in First Start and Breakthrough may have encouraged some localised demand in more affordable areas. However the eligibility criteria used, and in the case of WA, price maxima set, have arguably helped focus the market on affordable price points and product: a beneficial feedback.
- Were schemes to operate on a substantively larger scale, or without the constraints and regulatory frameworks of eligibility criteria, then concerns regarding the potential to put upward pressure on markets due to stimulating demand-side capacity may come into play.

4 FINANCING SHARED EQUITY

4.1 Introduction

This chapter explores how shared equity is financed and the financial contexts within which schemes currently operate in Australia and overseas. There are two foci to our discussions. Firstly, an overview of the financing arrangements of government-backed agencies is provided, outlining the similar structures within which these schemes operate but also highlighting differences in terms of governance and flexibilities to act as full commercial concerns.[13]

Secondly, the role of private-sector engagement and leadership in helping build the potential of shared equity is considered, including innovation in the financial markets to foster a conducive framework for greater lender, investor and consumer interest. As shall be discussed, the impact of the global financial crisis has had serious ramifications, certainly in the short- to mid-term, not least given the role of residential lending practices and complex financial instruments in pre-empting the crisis.

The structure to our discussions in this chapter should not obviate that distinctions between government- and market-led arrangements are inevitably blurred, and have become increasingly so. Government-backed agencies essentially operate within the market as commercial concerns, interacting with the financial markets much as other lenders do. Similarly, we live in an era where governments are stepping in to rescue banks, guaranteeing deposits, and taking steps to improve liquidity in the system.

Our focus in this chapter is on understanding innovative financing arrangements in relation to the operation of financial markets, rather than the scale and nature of potential subsidy or partnership funding mechanisms that may be required to support shared equity initiatives. The latter will be explored in Chapter 5, since unpacking the question of subsidy will be integral to a broader assessment of the benefits, and risks, attached to policy interest in shared equity.

4.2 Government-backed financing arrangements

As noted throughout this research, government-backed agencies such as HomeStart and Keystart have driven the development of shared equity arrangements in Australia. These agencies have combined a policy-responsive rationale with viable and indeed profitable operations within the market. Although forms of subsidy are involved – for example in terms of initial seed funding, or the benefits that accrue from government guarantees on funding/debt – they are required to operate as a commercial concern.

The existence of viable, profitable intermediaries in South Australia, Western Australia and the Northern Territory assisting lower income households enter and sustain homeownership is matched by the difficult legacy of organisations in the eastern states. In NSW and Victoria, memories of involvement in low start loan arrangements (HomeFund and Home Opportunity Loans Scheme (HOLS) in particular) remain as a policy scar continuing to feed considerable caution towards the return of such models. The relative fortunes of arrangements put in place by each of the states in the late 1980s and early 1990s highlight the significant risks involved for government.[14] They

[13] Insight draws upon Annual reports and related publications, and was further assisted through a series of interviews held with HomeStart, Keystart and HomeNorth in December 2008 as part of the sister AHURI Project (*Support for Lower Income Homeownership*) where shared equity considerations were also raised given their integral role in the wider activity of these organisations.

[14] There has been extensive discussion regarding the architecture of these schemes and their collapse, see for example: (for NSW HomeFund), Auditor-General's Office NSW, 1993; Breen, 1994; Freeman, 1991; Milligan, 2003); (for VIC HOLS), Knowles, 1992; Pullen, 1992; Strong, 1995, Talbot, 1993).

also point to the importance of ensuring that appropriate and necessary structures are in place in order to mitigate the risks and maximise the potential benefits of government taking a lender, or 'lending-facilitator', role. Key to this has been ensuring that the frameworks established provide an appropriate mix of government interest and control on the one hand, with sufficient freedom to operate effectively as a profitable but prudent lender on the other.

The following sections provide a brief overview of how financing arrangements for the largest of the government-backed agencies evolved and how they currently 'sit' within their respective policy and funding contexts. A crucial advantage shared by government-backed arrangements relates to the capital weighting required, and guarantees or support provided, effectively minimising the level of risks tied to loans secured on residential property. In a sense, these agencies share access to cheap money in the finance markets, with many of the associated risks mitigated. While there are strong similarities across these operations, there are also a number of important differences that shape the nature of the government-market nexus captured within each.

4.2.1 HomeStart Finance (SA): 'not housing, not treasury'

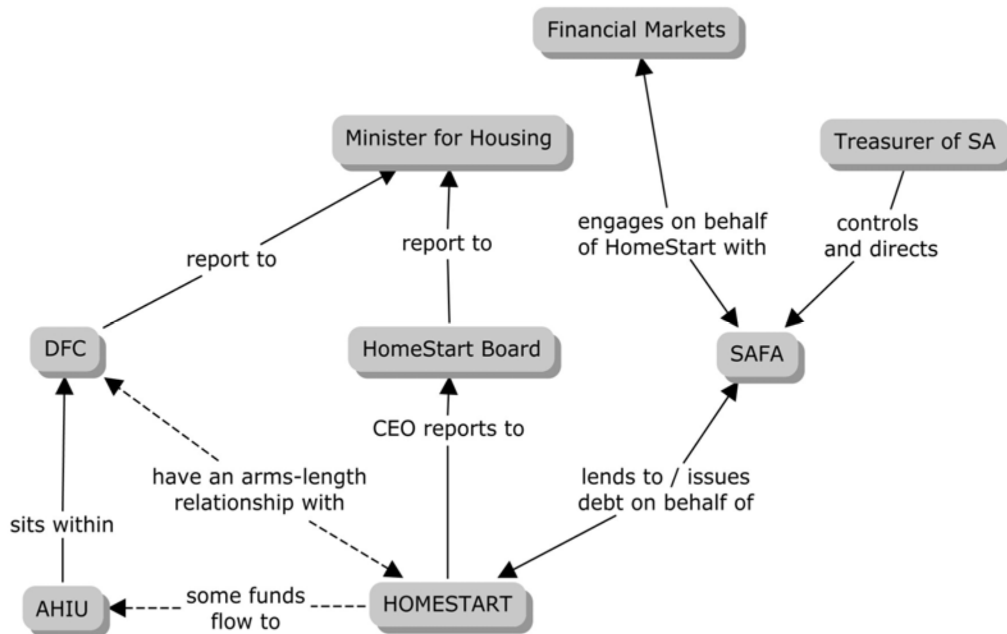
> '[HomeStart Finance] represents good practice within public sector lending for housing finance as it has provided a significant funding for home purchase at minimal risk for the public sector' (Kearins et al., 2004, p.53)

HomeStart Finance was established in 1989 and set up as a statutory corporation under the Housing and Urban Development (Administrative Arrangements) (HomeStart Finance) Regulations 1995. It has helped over 55,000 South Australians into home ownership. Building upon the $50m provided by the SA Treasury to establish lending activity, the organisation has contributed over $200m back to the state government. Its Annual Report for 2007-08 outlines an operating profit of $6.8m, a capital base of $153.4m, and across all loan types offered, over 14,000 customers (HomeStart Finance, 2008, p.9).

The success of HomeStart provides a strong case for long-term involvement and building up a portfolio through market cycles. Building on strong foundations of the South Australian Housing Trust, but emerging at the same time as schemes in other states were beginning to demonstrate significant concerns, HomeStart has developed into the most commercially oriented (and arguably most successful) of the remaining government-backed agencies. Fundamental lessons were learned from the fallout in the eastern states in terms of getting the product right and the need to start by building up credibility. Initially, loan portfolios swayed towards the less risky rather than those most in need. Once credentials had been established, risk profiles could then be extended.

Core factors underpinning HomeStart's continued success rests in reaching a viable operating scale alongside governance arrangements and degree of independence earned over the years. HomeStart essentially operates at a healthy arms-length from the Department of Families and Communities (DFC). It is run very much as a commercial concern, with staff, and Board members, predominantly drawn from business and finance sectors rather than government departments. Similarly, although working in close partnership with DFC, its policy steer is not overtly explicit, and the organisation has been free to develop and target products. These freedoms have provided a framework in which HomeStart has been able to play a central role in driving wider affordable housing objectives in South Australia.

Figure 8: Organisation and financial framework for HomeStart



How is HomeStart activity financed?

- → HomeStart borrows money and issues debt in the financial markets through the South Australian Financing Authority (SAFA), the state's central financing authority and captive insurer.
- → HomeStart sets out the terms that they want to borrow at, and SAFA goes out to the markets on those terms. As an agency under the remit of the SA Treasury, SAFA provides the credit rating and guarantee of government. This provides access to cheap money, but also ensures a strong degree of scrutiny. A fee is paid for the benefits of this degree.
- → A mix of funding is used, but there is a focus on borrowing at short-term variable rates which provide control in terms of matching assets with liabilities.
- → HomeStart has the authority to set its own interest rates without requiring approval from the Department for Families and Communities or Minister (with the exception of one legacy product).
- → Treasury/SAFA arrangements and requirements also ensure that HomeStart maintains a conservative asset to liability ratio. Inevitably this will vary dependent on new lending and redemption activity, however capitalisation is typically at higher levels than held by the mainstream banks.
- → HomeStart operates to return of equity (ROE) target. Although this ROE target is modest, having a target has ensured commercial discipline while enabling a lending profile other lenders would consider risky or non-profitable.

The finance provides some flexibility so that HomeStart is in a position to respond to increased demand at different times in the market cycle, as was seen for example with the arrival of the enhanced First Home Owners Boost in October 2008. However, quarterly lending caps are used as a tool to spread settlements over a period (about five years) to spread out risks over the property cycle.

As their products have minimal deposit requirements and do not require borrowers to take out Lenders Mortgage Insurance (LMI), there is a risk to the organisation of write-offs and negative equity. In order to protect themselves, HomeStart has set up a Risk Transfer Vehicle (RTV), where customers pay a fee at the time of the loan arrangement (typically $400-$600, compared to LMI, where payment on a high loan-to-value (LTV) loan may be many thousands of dollars). Since inception, the fund has accrued $45 million with very little call for payout to date given good economic conditions and low arrear rates.

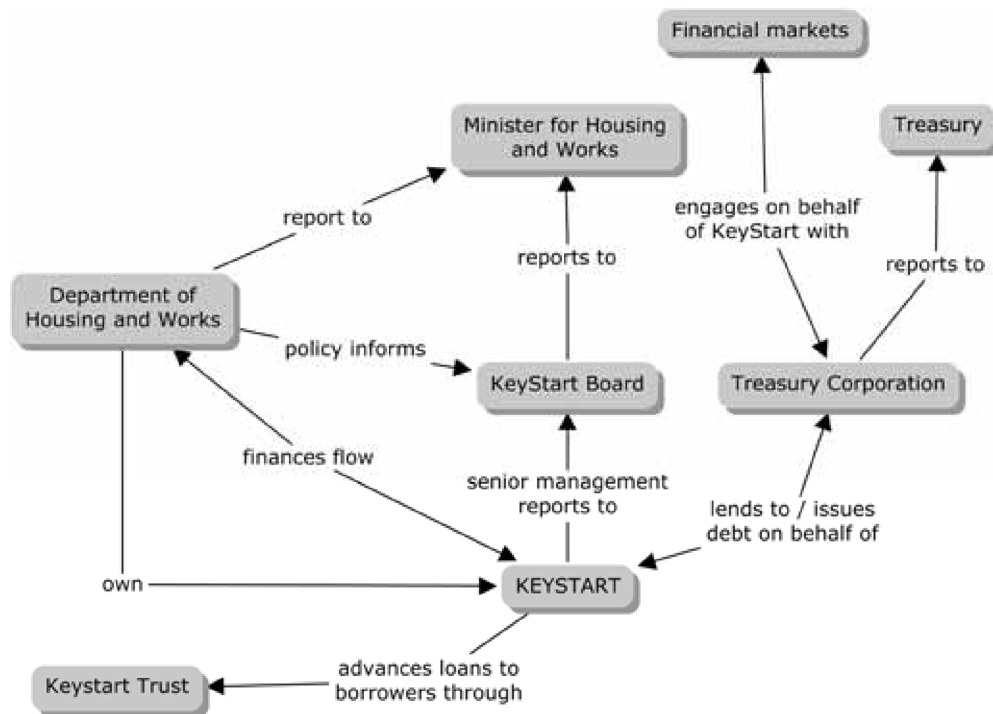
HomeStart's commitment to supporting lower income households is met without the vast majority of loans requiring subsidy (at least directly). Breakthrough is designed as a commercial model so that under modest price appreciation conditions the organisation recoups its funding costs plus provides a return that can be re-invested into the program. For the small number that do require subsidy, HomeStart had, until recently, cross-subsidised their products and offset this by paying a lower dividend to Treasury. Since 2007, Treasury has provided a cheque each year for direct subsidies for specific products such as Equity Start, offset by a higher dividend going back, assisting transparency. Profits are typically recycled back into the business and new loan provision. Those from EquityStart – the scheme targeted towards public housing tenants – flow to the Affordable Housing Innovation Unit (AHIU) within the Department of Families and Communities.

As part of the product evolution process, HomeStart is developing other innovative methods of funding the shared equity component of the loan facility, including the Brahma Green development being realised in conjunction with the City of Salisbury. The City of Salisbury Council has identified surplus land on which 11 two and three bedroom homes are being constructed. The properties are being sold at market value with customers taking out shared equity loans. The City of Salisbury provides the loan (since they act as the partner through their landholding) and this is administered by HomeStart. Affordability is assisted through stage payment of the land. Payments for the land will be received over three stages: a portion upfront (around 30 per cent of the market value of the land), a facility fee throughout the life of the loan (equating to around 2 per cent per annum on the shared equity component), and the remainder plus any share in appreciation at the time of sale or refinancing. Further to the success of the Brahma Green scheme, other local governments and landholders have signalled their intention to partner with HomeStart to roll out this model.

4.2.2 Keystart (WA): arms-length, but more tied to Treasury constraints

Keystart was established by the WA Government as a statutory authority in 1989 to enable a larger volume of funds to be raised than possible against the internal resources of the State Housing Commission and criteria of loan council. As with HomeStart, it had the good fortune in following schemes being put in place in the east, and was able to amend its model from low-start to credit foncier arrangements to avoid facing the same fate. After requiring public subsidy in its first two years, the organisation has since been sustainable and profitable. Since 1989, over 65,000 Western Australians have been assisted into home ownership by Keystart, accounting for $6.8 billion in home loans (Keystart Housing Scheme Trust, 2008). A net surplus of $20.1m was reported in 2007-08 (Keystart Housing Scheme Trust, 2008).

Figure 9: Organisation and financial framework for Keystart



Like HomeStart, Keystart operations are separated from the mainstream activities of the Department of Housing and Works (DHW), although its relationship with the department is more tightly structured. Closer ties take the form of more hands-on policy interest, for example in the scale of Keystart business (not least in terms of funding requirements from the Treasury Corporation for new schemes, for example, when Breakthrough was introduced), but also in the other direction, with the disbursement of profits from Keystart allocated throughout DHW interests.

How is Keystart activity financed?

→ Keystart originally borrowed from the financial markets through their company Keystart Loans Limited. They had a 'support' agreement (rather than guarantee, but in effect offering the same security) from the commission to borrow funds. Like HomeStart this provides access to funds at a favourable rate.

→ Since the late 1990s, Keystart have borrowed funds from the Treasury Corporation, the WA Government's Corporate Treasury services provider. Amendments to the *Western Australian Treasury Corporation Act 1986* made in 1998 enable the Treasury Corporation to provide financial management services to the WA public sector (WA Treasury Corporation 2008).

→ Keystart took advantage of this change and started issuing paper (selling-on their debt) into the markets. There are risks attached if investor demand is limited or they demand a high price, since the agency is then unable to on-lend at low enough rates.

→ As with HomeStart, a mix of funding arrangements is used. They issue term fixed rate funds, and then swap these into floating arrangements, which enables them to take advantage of spreads against the bank base rate.

→ A Treasury Committee makes sure it covers funding and operation costs and provides competitive interest.

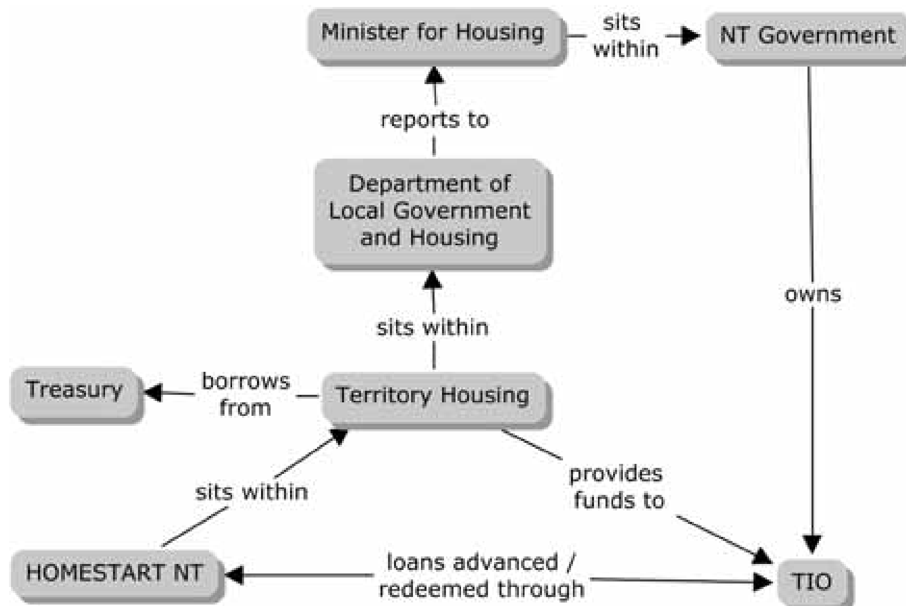
Any shared equity profits go into servicing debts against the $300m funding allocated for 2007-2010. Other profits may be used to help fund other Keystart products, but can also be used to fund other housing outcomes such as affordable rental schemes.

Although working with financial markets through the Treasury Corporation, Keystart is bounded by the extent to which Treasury is willing to respond to demand and lift borrowing limits. With the arrival of First Start in 2007, requirements increased substantially as a result of a significant proportion of the shared equity loan value (DHW's share) going onto the books. As discussed in the previous chapter, the early success of First Start quickly hit funding constraints of the model within which the organisation operates. A further $70m was made available, alongside eligibility criteria being tightened in order to contain demand and limit exposure of the Treasury in the current market context.

4.2.3 HOMESTART NT: operating within government frameworks

HOMESTART NT is a division of Territory Housing within the Northern Territory Department of Local Government and Housing (DLGH). Until early 2009, the division was called HomeNorth, and loan products (such as HomeNorth Xtra) followed this branding. Unlike HomeStart and Keystart it is not a statuary corporation but acts as a business arm and is expected to run at a profit. Although operated on a commercial basis, policy and product development functions are retained by Territory Housing. Products are administered through the Territory's insurer, TIO, which is also owned by the NT Government. Between 2004 and the end of 2007, over 1000 households were assisted into ownership through HomeNorth Xtra.

Figure 10: Organisation and financial framework for HomeStart NT



How is HOMESTART NT financed?

- → HOMESTART NT loans are administered by TIO, a government-owned entity, providing a form of guarantee from the NT government.
- → When a successful application is made, TIO do not use their money to cover the loan. They submit a loan schedule to Territory Housing, outlining the required amount by year.

- → Territory Housing borrows from Treasury and that money gets passed on to TIO
- → The reverse process happens when the loan is settled by TIO, with Territory Housing's share of the sale is returned to Territory Housing.
- → Funds are retained within the division to repay loans from Treasury and to continue lending operations.

Prior to its relaunch, HomeNorth Xtra had seen reduced activity over the past few years. The price caps introduced, as a result of concern over exposure to onward risk if prices were to fall, as well as debate regarding the extent to which government should intervene, constrained product viability in current market conditions. For example, with a regional price maximum of $350,000 in Darwin's northern suburbs – one of NT's most important markets – few loans had been made recently since few properties become available on the market at this price point. Where loans have been provided, these have typically gone towards the purchase of units. It is too early to determine the impact of revised eligibility criteria and product rebranding to HOMESTART NT, but the large increases in income and assets maxima would appear to respond to these tight market conditions.

4.2.4 More capital tied up in the partner's share, and greater uncertainty in redemption profiles

A strong learning curve for all schemes is the question of redemption profiles and discharge rates of shared equity products. This impacts on the level and trajectory of returns flowing back into the organisations, and hence their capacity to pay down any initial subsidy or lend to other households. Unlike standard loan arrangements, shared equity products hold a greater degree of uncertainty. Firstly, lending totals have substantially increased, much of it held by the agencies themselves in the form of their equity share. Secondly, the redemption of this significant share is uncertain: it may be bought out quickly, it may be purchased in gradual incremental steps, or it might not be touched until (and if) the property is sold. This impacts on balancing assets and liabilities within portfolios, influences capital adequacy considerations, and makes modelling return on equity rather difficult.

One reaction has been to structure and encourage shared equity arrangements to act as a stepping stone, enabling borrowers to move over time (and preferably in a more predictable timeframe) to standard loan products (either within the organisations themselves, or with a standard 'prime' lender). This echoes the aspirations of potential consumers in our focus groups, who would look to staircase their share up to full ownership as soon as possible.[15] This may involve direct or indirect incentives (or a combination of both) to promote 'staircasing' towards full ownership and thereby normalisation of the loan. Few 'force' the purchase of further equity shares (although some suggest that purchasers would need to do so if increases in household income enables this), but incentives such as exemptions from stamp duty within a certain time period (as in the case of First Start) may be provided.

An alternative response may recognise the need for shared equity subsidy to be treated as a different cost/benefit arrangement, with that subsidy seen as a long term property investment vehicle, rather than gap loan funding. This is a more substantive departure from normal Treasury funding arrangements, and will have a significant impact on how wider policy costs and benefits are framed and understood.

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[15] Although from our discussions with existing shared equity customers interviewed as part of the first stage of this project and reported in the positioning paper, actual levels of staircasing may not be as anticipated at the commencement of the loan.

4.2.5 Innovation in the absence of government-backed agencies

States without government-backed organisations have tended to see more limited innovation, although a number have recently moved forward with shared equity schemes driven primarily from their Housing Departments. The emergence of these initiatives is instructive in terms of establishing capacity without the framework and track-record provided by arms-length agencies. Tasmania's HomeShare covers a range of target markets – both existing social housing tenants and first time buyers purchasing new build or house and land packages – and partnership arrangements are entered into with the Director of Housing. Unlike the larger government-backed organisations, where customers take out a HomeStart or Keystart loan on their proportion of the equity share, loans for HomeShare are taken out through the Bendigo and Adelaide Bank. Here, the government has worked with a mainstream lender to provide the necessary scale and expertise to deliver the product in the absence of an arms-length government lender. Nevertheless, since the Director of Housing's equity share remains on the department's books, the debt and risks involved in holding that debt remain within the government.

The HomeShare model will be worth watching as it is rolled out. For those states without the benefit of arms-length agencies, the challenge of re-establishing such frameworks cannot be underestimated (an issue returned to in Chapter 5). Thus arrangements where state housing departments can work with private lenders can be seen to provide a useful starting point in re-establishing the government as lender (or at least lending-facilitator) role.

4.3 Developments within the financial market

During the conceptual development of this research back in 2007, it was envisaged that central to assessing the potential of innovative financing products would be a focus on the development of financial models, led by the private sector, which would underpin moving shared equity to scale as a full blooded market product without direct government subsidy. In part this can be seen to stem from optimism that the 'right' shared equity product would make sense to lenders, consumers, policy-makers and investors alike. If policy settings, incentive and subsidy frameworks can be structured to enable better delivery of objectives, making more efficient use of available funds, or stretching the reach of benefits, then the rationale for encouraging the private sector to take up the challenge is understood.

As discussed in the preceding section, even where government-backed agencies take the lead, these arrangements are – particularly in the case of HomeStart – very much commercial concerns, operating within financial markets. They issue debt and seek a return on the government's equity. In this regard, they operate as any other lender – albeit to different profit expectations – and thus innovations within the market and financing frameworks, or shifts within the regulatory environment, will also impact on the future potential operation of those initiatives.

4.3.1 Private sector developments

Our discussions with financial and institutional stakeholders in the initial stages of this project outlined an environment that continued to express interest in shared equity arrangements, but one also shaped by a degree of grounded, pragmatic caution (Pinnegar et al., 2008). A number of respondents expressed their reservations, citing product complexity, a lack of experience and market understanding of how the products would perform (for example in terms of redemption profiles), and the heightened levels of risk arising from this uncertainty.

Others felt that it was a market whose 'time had come', and with the arrival of Rismark's EFM product, there was a degree of expectation that private-sector led products would help expand the reach of shared equity in the coming years. Indeed, late 2007 and early 2008 saw the EFM winning a number of awards: 'the most innovative lending product in 15 years' (InfoChoice, 2007, quoted by Rismark on their website); and 'Best new product of the year' (Money Magazine 2007). Commenting on this success, Christopher Joye noted that 'we're [Rismark] proud to be Australia's shared equity pioneer' (Mortgage Professional Australia, 2008, p.14). By 2008, two thousand mortgage brokers had been accredited to sell EFM nationally, but how this has translated into actual demand for the product to date is less clear.

However at this time, the financial landscape was starting to change dramatically as the credit crunch and its evolution into global economic recession took hold. A detailed analysis of the drivers behind, or resulting outcomes, of the current global financial crisis is far beyond the scope of this report, and indeed it is clear that the true extent of the impact on housing, economic and financial frameworks moving forward will continue to unravel. Berry et al. (2009) provide an insightful and detailed overview of the unfolding of the subprime mortgage crisis and the rise of systemic risk in the banking system as part of research currently underway by the AHURI RMIT Research Centre. Here, we focus on the implications for shared equity arrangements in this current context.

Not wanting to get overwhelmed by the current hiatus – there is a risk of throwing out the baby with the bathwater – it is instructive to note that, even before the onset of collapse and effective removal of liquidity from the markets, lenders had struggled to innovate and bring shared equity products, the EFM withstanding, to the market. Despite years of strong economic growth, booming finance markets, the benefits of deregulation, the consistent upward trajectory of property prices, and the existence of large investment vehicles looking for somewhere to invest, this continued cautious interest, a 'watching brief' by even the more innovative institutions, indicates the challenges that existed before the current environment.

Similar caution has prevailed in the UK, despite a longstanding commitment by the government to working with lenders to move forward shared equity arrangements. The 2006 Shared Equity Task Force identified the limited progress at that time in the development of a private shared equity market as a key barrier to expanding opportunities. The follow-up Pomeroy Review (DCLG, 2008), reporting in the early stages of the financial crisis, noted that since the Task Force Report there had been very little development of the sector, and indeed the only private-sector led, unsubsidised, product available in the UK – Flexishare from Advantage and Morgan Stanley – had been withdrawn. Pomeroy's stocktake reiterated that interest in developing schemes remained, but there was an inherent difficulty in finding investors willing to take exposure to house price risk at any significant level. It was concluded that, at least in the prevailing context, 'there is no major measure that government could take which would radically transform the situation' (DCLG, 2008, p.6).

4.3.2 The Global Financial Crisis: 'innovative finance' implicated?

> '[New securities and related derivatives] were once considered 'state of the art' – dazzlingly complex, capable of spreading risk, and constructed using sophisticated mathematical models to price the risk. But it turns out that their very complexity makes it incredibly difficult now to know where the risk actually resides or how to price it' (Yellen, 2009, p.4)

> '… the markets for more complex structured credit products … have also been under considerable pressure due to widespread investor distrust of these instruments' (RBA, 2008, p.5)

In most regards, the challenges facing shared equity development and financing given the current financial climate are similar to those experienced by 'normal' loan and investor considerations. However, both the origins of the global financial crisis, and the key elements of market operation implicated for being at the heart of the collapse and underestimation/misunderstanding of risk, do raise specific challenges and issues for shared equity. Clearly, *shared equity and subprime arrangements are quite different beasts*. Furthermore, the expansion of subprime loans has not really been a problem in Australia, with non-conforming loans accounting for only around 1 per cent of total mortgage lending compared with 13 per cent in the US (RBA, 2009). Generally, lending standards have remained more stringent and the Australian banking system has only limited direct exposure to the types of securities – the US subprime market[16] and collateralised debt obligations (CDOs) – that have been at the heart of losses seen elsewhere.

Nevertheless, the steep decline in trading of residential mortgage-backed securities (RMBS) hits complex instruments and lending to marginal groups especially hard. An important vehicle for developing private sector engagement and market operation in shared equity products – tying together large scale investment funds with residential mortgage-backed securities (RMBS)[17] – echo similar characteristics of complexity, uncertainty and potential risk. There are substantive differences between AAA rated and subprime assets, but as the current financial environment has demonstrated, the market's collapse in confidence in knowing what has been packaged up, and what those asset classes are now actually really worth, ensures that for the short term, such assurances are largely circumstantial. As banks seek to recapitalise in order to underpin their viability and reduce their leverage, there has been a commensurate increase in risk aversion and product reappraisal. Although there are other routes that private sector led products can take without involving RMBS – for example pension funds could simply invest in the shared equity component – the appetite for innovation tied to residential lending generally is likely to be hit, at least in the short- to mid-term.

Possible constraints facing the leading private-sector led shared equity product in Australia – Rismark's EFM – are highlighted in, Joye and Gans' proposals for the creation of a government agency, 'AussieMac'.[18] Their proposal called for using the country's AAA rating to be used as a guarantee against AAA rated Australian residential debt. The authors argue that a guarantee would enable AussieMac to issue substantial volumes of low cost bonds, providing lenders originating 'high credit-quality' home loans with assured access to finance and thereby helping ease liquidity issues[19] (Joye and Gans, 2008a; 2008b).

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[16] The availability of subprime loans in the US had expanded greatly from the end of the 1990s, fuelled by policy interests coupled with the deregulation of markets making credit more available to traditionally excluded, traditionally 'riskier', groups.

[17] RMBS comprise a contract made up of mortgage debt that can be assigned and traded. Debt from a number of mortgages is bundled up, repackaged, and securitised, with the risk tied to the created product valued through established ratings and insurance processes. These securities can then be traded, enabling the originating lender to move those mortgages to off-balance sheets, freeing up funds.

[18] Joye being the chief architect of the EFM.

[19] Joye and Gans proposals for AussieMac pointed towards Fannie Mae and Freddie Mac as useful models, fulfilling a similar role in US residential financing market. This endorsement was made earlier in 2008 prior to their move to conservatorship in September.

The Federal Government announced an $8 billion RMBS purchase plan in October, whereby the government (and others) invest in mortgage backed securities put forward by banks and fund managers. Packages issued have typically involved tranches of different quality securities. The Federal Shadow Minister for Housing and Local Government, Scott Morrison MP, called for $500m of the $8billion purchase plan to support shared equity loans, noting that 'the chief long-term investors in shared equity are super funds and they are withdrawing their support from shared equity due to losses in share portfolios and use of their rigid asset-allocation models' (Morrison, 2008). To March 2009, $3.3 billion across seven issues has been invested, although the extent to which arrangements have been able to increase liquidity for smaller and non-bank lenders – essentially entirely dependent on the securitisation market – remains debated (Irvine, 2009; Riseborough, 2008).

For the short term at least, much of the blame of the current crisis has been ascribed to the opacity created by clever but with hindsight poorly regulated, poorly priced, and poorly understood, vehicles. However, there remains considerable academic and commercial interest in recognising the role innovative financing frameworks may play as a means of providing greater risk management for homeowners (Case et al., 1993; Shiller, 2003; Smith, 2009; Smith et al., 2008). Here, shared equity arrangements can provide a means for individual households to mitigate against the risks of price volatility (Whitehead, 2008).

As Susan Smith notes, 'perhaps the problem for home buyers is not that they have been drawn too far into the working of financial markets, but rather that they are not adequately protected by the instruments invented to handle this' (Smith, 2009, p 213). Trading derivatives in a secondary market, determined by performance of the asset value or index, rather than the property itself, enables a distinction between the home as shelter and the home as investment. This provides a means of transferring risk through 'hedging' and managing the extent of exposure within this asset by having a large proportion of one's individual wealth tied up in a particular property.

For example, use of 'futures' and 'swap' options might see a struggling owner with little equity built up and facing difficulties in meeting repayments over the short term sell off a portion of future returns for a lump sum that can tide them over. Such arrangements are also seen as a means whereby the uncertainty of market trends can be mediated and some of the risks for households with their capital overly represented in this one asset class can be offset. 'SwapRent', developed by Ralph Liu in the US, has created a derivatives approach to enable 'economic renting' while owners keep legal ownership of their property (and other investment property). The model is structured around the relative financial and affordability considerations of ownership versus renting and seeks to be responsive to the fact that this equation changes over time (Liu/Advanced e-Financial technologies, 2006).

Given the failures seen, not least by a tendency for banks to underestimate risks in buoyant markets, and indeed markets themselves not knowing the extent of their exposure to toxic debt, there is an opportunity to reflect upon a number of prevailing assumptions tied to such innovations helping to mitigate risk. Firstly, it is valid to question whether it remains appropriate to push for financial vehicles that will enable 'value' tied up in residential assets to be traded as other investment classes. Do we acknowledge that housing – and certainly in the form of owner-occupied, primary residences – is and should remain a distinct asset class? Would this represent an opportunity lost in terms of enhancing the management of that asset, but equally a means of limiting the level of risk individual households may become exposed to?

Secondly, the proposition for the consumer presented by such arrangements potentially misunderstands or overestimates, some of the key drivers (both rational

and irrational) shaping the homeownership goals of many. Drawing upon interviews with 35 homeowners in the UK (as part of the ESRC-funded project 'Banking on Housing: spending the home'), Smith et al. (2008, p. 98) found that while there was some interest in such models as a means of diversifying housing investment, the majority 'like most home buyers, [were] risk averse; they subscribe to the widely held industry view that ordinary households should not dabble directly in derivatives'.

Despite Smith et al.'s (2008, p.99) compelling argument that 'it might on balance be better rather than worse if ordinary households could benefit from the financial instruments that large institutions already use to manage risks and secure assets', more caution is expressed here. This both reflects a degree of scepticism on whether such arrangements can be made to work to benefit individuals rather than intermediaries, but more so to reiterate that there are risks tied to enabling the market to overtly determine the criteria against which innovation is understood.

4.3.3 A Source of credit, security: shared equity as part of the solution?

Given that the substantial knocks within the market have hit the private-sector led arrangements hardest, it is perhaps unsurprising that the shared equity initiatives that have survived – and indeed come to the fore during the global financial crisis – are government-backed or initiated, and involve some form of subsidy.

This section highlights how shared equity has been enrolled in two different ways, responding to the immediate challenges seen in the housing market in the UK and US, where difficulties have become significantly entrenched. The first considers the use of government-backed arrangements as a means of channelling access to credit for first time buyers and assist parallel goals of supporting the residential construction industry. The second identifies the use of shared equity frameworks to enable homeowners at risk of foreclosure to restructure home loan repayments while staying in their properties. Here shared equity not only provides the means of doing so, but also represents a politically acceptable compromise in the advent of any future equity gains in return for taxpayer support provided at the time of loan restructuring.

A credit lifeline: helping consumers, developers or both?

The UK housing market peaked in mid-2007, and in the 12 months to February 2009, two of the leading house price indices (Halifax and Nationwide) reported that median values had fallen by 17.7 and 17.6 per cent respectively. Further falls are expected. After many years of 'cheap money', the credit crunch has dramatically reduced the availability of finance to prospective purchasers. The Council of Mortgage Lenders (CML) reported that the value of net mortgage lending contracted by over 70 per cent between 2007 and 2008, and the number of first-time buyer loans almost halved from 357,800 to 194,200 over the same period (Council of Mortgage Lenders, 2009). There has also been a precipitous fall and reshaping of the mortgage product landscape: by February 2009, just 1542 different home loans were available in the UK compared to over 15,000 in July 2007 (Burridge, 2009).

With the scale of likely contraction becoming rapidly apparent, and estimates for house price corrections pointing to continued falls, lenders have stopped lending. They need to recapitalise from over-leveraged positions, and at the same time do not want to expose themselves to lending on an asset where values are falling. The outcome is that first time buyers, who may have been looking for a 95 per cent loan-to-value (LTV) ratio, now require a 20 to 30 per cent deposit. In such circumstances, this important purchaser cohort has not been able to take advantage of increasing affordability in the market due to a lack of access to credit. In these conditions, shared ownership and shared equity arrangements have seen a significant increase in

uptake.[20] In part, this reflects the redesign of schemes such as Homebuy, increased subsidy commitment, and the easing of eligibility criteria, but it is also that such initiatives 'offer very affordable funding at a time when traditional mortgage lenders are not offering money at affordable terms' (Carpenter, 2009, p.6).

As the extent of the housing market downturn deepened throughout 2008, another shared equity scheme, Homebuy Direct, was introduced as part of the government's Housing Market Rescue Package. Homebuy Direct shares longstanding objectives of shared equity arrangements in targeting first time buyers, but also represents a policy response that aims to address the difficulties being faced by the house building industry. The scheme provides access to finance otherwise unavailable to purchasers, tied to properties that could not be sold. It is underpinned by £300m of public subsidy, with buyers being offered an equity loan of up to 30 per cent of the purchase price. The equity loan is co-funded on equal terms by the government and the developer.

'Mutually beneficial' goals are explicitly pitched under such arrangements (DCLG 2009a), assisting the purchaser to obtain a mortgage but at the same time 'providing a targeted boost for the housing market by stimulating more transactions', and 'helping maintain the capacity of the house builders industry to respond when market conditions improve'. For lenders, the government and developer provision of this sizeable equity loan in effect provides a substantive deposit, and provides a good buffer on the remainder of the mortgage.

However, critics question whether using shared equity arrangements, and therefore first time buyers, to stimulate the market against a backdrop of prices that are heading firmly downwards, is appropriate (D'Arcy. 2008). There has been some concern that Homebuy Direct may simply replicate the over-leveraged models now withdrawn from the banks, compounded by negative equity. Lobby groups that emerged during the housing bubble, such as www.pricedout.org.uk and www.housepricecrash.co.uk have also been vocal in their concerns, seeing the recent expansion of shared equity opportunities as a means of propping up inflated, unsustainable prices, rather than accepting revision to more affordable levels.

Shared equity as a lifeline against losing your home

The second area of shared equity's complex enrolment in responses to the global financial crisis is tied to helping people at risk of falling out of homeownership. As loan default rates and foreclosure increase significantly, shared equity, buy back, and rent/buy schemes are being explored as a means of enabling households to stay in their homes rather than face repossession which is costly to all parties involved. In the US, Hope for Homeowners (H4H) was announced in July 2008 and put into effect by October.[21] In a falling market, with negative equity facing a growing number of households, options for remortgaging a current loan whose value now exceeds the current value of the house (where owners are considered 'underwater') are highly constrained. The initial arrangements established through H4H aimed to acknowledge a range of mutually beneficial objectives, and ensure that all parties involved share both the potential costs and risks through loan modification.

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[20] Open Market Homebuy [OMHB] saw applications grow from 10148 in Q3 2007 to 17643 in Q3 2008 (+73.9% and completions from 161 to 693 (+330.4%). The shared ownership product New Build Homebuy [NBHB] saw completed sales increase from 1238 to 1916 (+54.8%) over the same period. (DCLG, 2009a).

[21] Hope for Homeowners (H4H) provides a core element of the *Housing and Economic Recovery Act* 2008, with access to funds made available through the Troubled Asset Relief Program (TARP) established in an attempt to free up markets seized by toxic debt.

In return for refinancing mortgagees at risk of foreclosure through the Federal Housing Agency (FHA), lenders would be required to write down the size of the mortgage to a maximum of 90 per cent of the home's new appraised value (HUD, 2008). In order to protect against concerns that this assistance would provide inequitable support for recipients if and when house values started to appreciate, profit sharing arrangements were included. The equity sharing arrangements put in place were highly complex, calculated on the reappraised value and restructured loan amount, how long the owner stayed in the home after switching to a H4H loan, and the value of the property at the time of sale. FHA equity entitlement arising from the refinancing process would decrease over time. The framework was further complicated by an equal split between the FHA and the owner on all equity gains made on the property between refinancing and the time the property is sold (or when further refinancing takes place).

Up to $300billion was made available, with initial expectations that 400,000 owners would apply for the scheme. Reporting on the very slow take-up of the scheme in its first months, the *Washington Post* (2008, p.A22) noted that the terms of H4H may have 'been the best available deal, politically, but it doesn't make sense, economically, for very many people. Therefore, hardly anyone has chosen it'. Just 25 loans had been modified under these arrangements by February 2009 at the time of the release of the Homeownership Affordability and Sustainability Plan (Naylor, 2009). Of direct interest here, the shared appreciation conditions tied to refinancing can be seen as a contributory stumbling block. They were removed as a condition of TARP eligibility in amendments announced in February 2009 (see Table 10).

Table 10: Amendments to troubled assets relief program/title V

- → Eliminates 3% upfront premium.
- → Reduces 1.5% annual premium to 0.55-0.75% based on risk based pricing
- → Raises maximum LTV from 90 to 93% for certain borrowers
- → Eliminates government profit sharing of home price appreciation over market value of home at the time of H4H refinancing.

Summarised from: www.commoncause.org/site/pp.asp?c=dkLNK1MQIwG&b=4923225

Shared equity arrangements have also been enrolled in the UK to assist households at risk of repossession, albeit with a more focused approach and one that builds upon the long trajectory of such initiatives.22 The £200m Mortgage Rescue Scheme, announced in November 2008, is intended to help up to 6,000 households over two years (DCLG 2009b). The package has two options:

- → A shared equity option, designed to help householders who have an equity share in their homes and are facing a payment shock from remortgaging and/or higher living costs but likely to retain current income. This will mean 'staircasing' down: selling a share of their home to a housing association.
- → A government mortgage-to-rent option, designed to help the most vulnerable households with little chance of sustaining a mortgage and unable to meet lenders' requirements. Here the Housing Association clears the secured debt (buys out the mortgage) and the applicant pays rent to the association.

The scheme is inevitably limited, not least in its scale and level of available funding, but offers a focused response that utilises options for equity sharing where

[22] The Mortgage Rescue Scheme sits alongside the more substantive Homeowners Mortgage Support (HMS) Scheme, first announced in late 2008 and introduced in April 2009. The scheme enables borrowers to move onto interest-only loans.. Further discussion of schemes being put in place to assist owners at risk of falling out of homeownership is provided in Pinnegar et al. (forthcoming).

appropriate rather than seeing this option as a sensible or viable means of addressing foreclosure and repossession concerns. For instance, it cannot provide a refinancing route for the increasing proportion of homeowners moving into negative equity.

In Australia, government-backed shared equity arrangements have been sufficiently flexible to enable households to step down or refinance in order to reduce loan repayments. WA's SafetyNet scheme, targeted at existing Keystart customers, takes a phased approach based upon determination of a household's current financial position, the cause of financial difficulty, the length of time those difficulties are expected to last, and assessment of the maximum repayments that can be sustained.

- Phase 1 reduces the repayments required for a specified period of time to allow time for the household's finances to recover.
- Phase 2 evaluates whether changed longer term circumstances are sufficient to sustain arrangements whereby Keystart take an equity share in the home.
- Phase 3 (subject to the outcome of Phase 2) sees Keystart purchase up to a maximum of 30 per cent equity in the property. (www.keystart.com.au/key/documents/SafetyNet.pdf)

HomeStart's Breakthrough loan also provides the opportunity for owners in South Australia (not necessarily existing customers) to refinance from full home loans to shared equity arrangements as a means of reducing their repayments.

4.4 Summary

This chapter has assessed the financial contexts within which shared equity currently operates in Australia. Firstly, an overview of the financing arrangements for the larger government-backed agencies in SA, WA and NT has been provided. Secondly, the wider operation of financial markets and the potential for greater private sector engagement and interest has been discussed. Inevitably any dichotomy drawn between the two is a false one, and innovation should be seen as a two-way process rather than simply limited to assumptions that 'market-led' is always best, fuelled by the development of ever more sophisticated financial tools. Innovation is also captured in outcomes that are understood by consumers, lenders and policymakers, and balance a range of requirements and expectations.

Australia's government-backed agencies may have appeared rather conservative and cautious in recent years in terms of their engagement with the market. Protected behind guarantees or support agreements, they have been risk-averse in the market, tending not to expose themselves to the potential for higher margins (and higher risk). Analysis is unlikely to shed conclusive light on whether the existence of such arrangements has been an important factor in mitigating Australia's exposure to subprime concerns, not least given the benefits of a well-regulated banking system (certainly in comparison to other advanced economies) more generally. Furthermore, not all states/territories benefit from these agencies, and while parts of Western Sydney and Melbourne's fringe are more exposed, nationally, the mortgage sector is in good shape relative to many other economies. Nevertheless, these agencies have quietly led innovation and collectively helped over 100,000 lower income Australian households enter homeownership over the past 20 years. The large majority would not have been eligible for loans, at least on affordable terms, with another lender.

By contrast, uptake of private-sector shared equity initiatives in the current financial climate is likely to have been somewhat constrained. While this may be seen as an inevitable short term setback, the hesitation and unwillingness of the private sector to engage with these provisions on a large scale even before the credit crisis is telling. Shared equity arrangements alter the traditional relationship in terms of debt

provisions for both borrower and lender. Fundamentally, on the part of the lender, it shifts the relationship from one of debt provider to a hybrid of debt provider and equity partner. Even in good economic times, their complexity and limitations may outweigh their potential benefits and struggle for viability when tested in the market. This raises a core issue to be considered in the final chapter: if it is argued that government engagement and subsidy are required to make shared equity 'work' (and this chapter has pointed to the relative success), then the fundamental question remains as to why government should be involved in these complex arrangements? Why does shared equity represent a wise use of tax dollars?

4.4.1 Summary issues to take forward

Innovation in shared equity depends on more than simply getting private lenders and the financial markets to deliver.

- → Shared equity is *not* the same as subprime, but complex products *are* implicated in the crisis, as is lending to those perceived as being a higher risk. Much of the innovative development that underpinned prospects for greater private lender involvement has become decoupled, at least in the short term.
- → Even before the current climate, when the global economy was somewhat healthier and had enjoyed very strong, robust growth in house prices, the market still found it difficult to bring non-subsidised private sector-led products forward.

The benefits of government-backed arrangements should be acknowledged as we move towards a more cautious financial climate.

- → Government-backed agencies have provided key sites for innovation in products assisting lower income households to access and sustain homeownership.
- → Shared equity products represent the fastest growing sector in agency portfolios.
- → They have, through government/Treasury guarantees or support measures, had the benefit of access to 'cheap money'. They operate, however, as financial concerns and provide a sustainable return on equity.
- → Market activity – housing and financial – is far from predictable. Government-backed models can provide a sustainable starting point. They also provide a framework for managing the reduced risk appetite of lenders.

Recognising the benefits of government engagement – and subsidy – does not preclude the importance of working with lenders.

- → Government-backed agencies need to have sufficient arms-length operation to act as commercial concerns within the market.
- → Variations in the governance structures of each of the SA, WA and NT agencies highlight the need to provide optimal conditions for those frameworks to work efficiently at the government-market nexus.
- → The most populous states, and our three largest cities, have very limited access to shared equity arrangements. Where they do not exist, there is the potential of building partnerships with private lenders as a starting point. The relationship established between Housing Tasmania and Bendigo and Adelaide Bank in the development of HomeShare may provide an instructive framework here.

5 POLICY, REGULATORY, FUNDING FRAMEWORK AGENDA

5.1 Introduction

> 'There are things for and against. Like I said, it's your home, and the bottom line is at the back of your mind ... you've got a silent partner but would you ever have got to have your home without that silent partner? Maybe never in your lifetime.' (Liverpool, moderate income, female)

This chapter brings together the insights from consumer, market and finance perspectives and looks towards policy interest and engagement in shared equity arrangements and its contribution to wider housing policy objectives going forward. Together with our initial findings from the first stage of the project, reported in the positioning paper, the research has sought to:

- Increase understanding of the strengths and weaknesses of a range of shared equity models employed both in Australia and overseas.
- Identify consumer awareness and assessment of these products/initiatives, alongside institutional, lender and policymaker perspectives.
- Consider the market conditions necessary for shared equity to be viable and to identify the potential impacts such products in turn may have on the housing market.
- Determine conditions to support the movement of shared equity, *if appropriate*, to scale, and the key requirements for governments, lenders, investors and consumers alike to facilitate this.

In this final chapter, we focus upon policy and funding considerations, and discuss options for institutional arrangements that maximise the housing outcomes desired. In this regard, we clarify the nature and scope of any policy framework for shared equity and at what *scale* policy interest should focus.

The timing of our research findings is, of course, highly pertinent. Had we been reporting at the height of the market cycle rather than moving towards the bottom of that cycle, the issues arising from those findings are likely to have been couched to a certain extent in different terms. As it is, prevailing worldwide economic conditions make discussion of innovative financing arrangements, and particularly those dependent on housing market growth and targeted towards lower income groups, rather difficult. Indeed, these conditions are arguably 'deadly for advocates of shared equity arrangements'.

These difficulties and dangers are noted and, in the short term, a retreat from overtly pushing the benefits of shared equity may be an appropriate response. Nevertheless, the case can be made for continued policy interest in facilitating homeownership, recognising the need for any such engagement to go hand-in-hand with ongoing *responsibilities* towards managing the possible risks as well as the wider benefits tied to those aims.

As shall be discussed, the research provides the basis for support for the *targeted* use of shared equity initiatives nationally, and recognises the important contribution such arrangements can make in helping deliver core objectives within the National Affordable Housing Agreement (NAHA). However, this support is framed by a number of factors:

- → The current financial climate provides a timely reminder that there are substantive risks as well as benefits tied to homeownership: it is not a silver bullet towards broader social policy of wealth generation and asset-building.
- → The complexity of the arrangements and benefit of government engagement, not only in terms of subsidy as well as an ongoing supportive framework, also indicates that shared equity should not be seen as a mechanism for countering the challenges of housing affordability on a broader scale. In this sense, it is positioned as a relatively niche vehicle.
- → Our findings also offer support for the delivery mechanisms that a number of states and territories – but not all – benefit from, grounded in recognising that these government-backed arrangements represent a sustainable, responsible and targeted means of facilitating both mobility and wellbeing at this transitional space between renting and ownership.
- → This does not, however, preclude the need for engagement across all levels of government, both in terms of providing funding and regulatory support (Federal level) and facilitating implementation and delivery of initiatives (Local Government level), or exploration of partnership opportunities with the private sector.

5.2 A challenging, but vital, policy space

Providing support at the margins of homeownership will always represent a risky arena for housing policy and the market. The onset of the global financial crisis, with origins traced back to poor lending practices and complicit policy in the US, highlights the issues associated with expanding homeownership in an unregulated market. It also undermines government's explicit and implicit role in promoting access. Furthermore, the systemic and individual risks associated with tying economic and welfare regimes to asset generation through homeownership are being increasingly debated and mapped out (Smith, 2006; Smith et al., 2008). Although distinctions can and should be drawn between policy goals and the quality and nature of the vehicles used to attain those objectives, the assumptions behind promoting homeownership for more marginal groups, especially within markets where housing can be considered overpriced, are likely to become more aggressively challenged.

5.2.1 Ideological promotion versus strategic facilitation

In recent years, long-term government interest in supporting and assisting access to homeownership has, in a number of international contexts, become overlain with more explicit target-driven objectives to increase ownership rates. In the US, increasing homeownership opportunities for traditionally marginalised groups was given added impetus during the Clinton administration during the 1990s. More recently, as housing wealth disparities became increasingly prevalent during the housing boom in the UK in the early and middle part of this decade, the government advocated a desire to see one million more homeowners, and to increase ownership rates from around 70 per cent towards 75 per cent (HM Treasury and ODPM, 2005; ODPM, 2005). Given the high proportion of households already in the tenure, such increases would require shifting homeownership 'downwards' towards those on lower incomes.

Although the current financial context and housing market response in many countries has pulled optimistic assumptions about the benefits of ownership into sharp relief, it is unlikely to signal a retreat from continued policy support and commitment to making the tenure accessible to those who aspire to, and can sustain, homeownership. However, a more balanced understanding of the risks involved, and the limitations of the private sector to effectively manage and price those risks, is sensible. An important distinction can be drawn between ideological promotion on the one hand,

and a role for government in facilitating ownership in a targeted way to address barriers causing to mobility on the other:

- → Even if markets were to be more efficient, equitable and more reliable in terms of tracking a sustainable trajectory, there will always be a tranche of aspirant, as well as existing, homeowners who straddle this part of the housing continuum and who legitimately the state may wish to assist.
- → The housing market in itself is unlikely to resolve continued challenges around this nexus. Thus even if (when) much of potential overpricing in the market unwinds, there is a continuing policy role to be played in providing opportunities for mobility, ongoing support, and preventing the risk of falling out of ownership.

As such, policy involvement may be seen as integral to wider objectives, is ongoing rather than temporary or a one-off, and must be relevant and appropriate across market cycles.

5.2.2 Is shared equity an appropriate response in this difficult policy space?

Shared equity is one response. As discussed throughout this report, it is not a straightforward one, and introduces a degree of complexity for all parties involved. In policy terms, it requires a duty of care which reflects an ongoing partnership for the duration of that loan. It requires administrative frameworks, regulatory structures and support mechanisms to be in place that can respond and evolve over time across a range of policy and market contexts. In the context of community equity schemes, it will also necessitate capacity building and development of a housing association sector or equivalent to act as partner with long-term interest in an affordable housing portfolio.

The level of success (or not) in encouraging greater private lender engagement also reflects the degree of unknown risk involved. The nature of the traditional mortgage is that lenders manage their risk by lending funds to clients expecting a reliable, predictable redemption of that loan. In return, the mortgagee takes on the risks associated with property price appreciation or depreciation over time. Shared equity rewrites these terms, with the equity partner also expected to take on risks tied to repayment of the mortgage and share risks tied to capital gains. Partnership working with government can help ameliorate some of these risks, but nonetheless the actual need for, and existence of, such partnerships in itself acts to reinforce that complexity.

The current climate adds further pressures on the relative attractiveness of shared equity. As discussed in chapter 3, it works better for all parties in housing markets with a sustainable growth trajectory, and needs to be responsive to changing market conditions. There are also risks attached to such arrangements being co-opted for multiple goals, potentially compromising the viability and attractiveness of such tools in the long term. As noted in the last chapter, the UK Government has increased emphasis – and funding – on shared equity arrangements during the credit crunch and housing market collapse not only as a means of providing a credit stream for first time buyers, but also as a means of helping underpin the housing construction industry. If the market continues to fall, economic recession deepens and the spectre of large-scale negative equity looms, there are clearly risks for policy engagement in this space, and the innovative financing arrangements enrolled are at risk of being damaged through implication.

Despite this caution, it is argued that shared equity schemes can play an important role in helping to assist household mobility at the margins of ownership. Justification for policy engagement in these complex arrangements revolves around the very fact that the margins between renting and ownership for certain household groups requires ongoing rather than one-off support to ensure sustainable outcomes.

5.3 The costs and benefits, in broad terms, to government involvement in shared equity schemes

> 'Ultimately, the question of how any subsidy is to be delivered will be answered at a political or ideological level' (Yates, 1992, p.106)

It is not the intention here to provide a detailed cost/benefit analysis of government involvement in shared equity arrangements. There are a number of reasons for this.

- The research did not set out to quantify the tangible and intangible housing and non-housing related benefits that may or may not arise from assisting households into homeownership[23]. The policy considerations across which shared equity conceivably sit and the direct and indirect subsidy and taxation arrangements that shape the housing policy landscape ensure that attempts to isolate specific costs and benefits are incredibly difficult.
- The costs and benefits involved potentially stretch far beyond the balance sheet of a simple transaction, and will in large part be shaped by the governance structures and policy-market interface of the administering organisations (for example, to what extent are they free to act as commercial concerns?), and the scale and nature of the programs involved.
- We remain at the early stages in terms of understanding the actual level of subsidy involved given the trajectory and redemption profile of loans remains. If the products perform as hoped for (as a transitional arrangement), then the actual level of subsidy will look quite different compared to the customer who does not step up, or move, for 20 years.

Over the years of their operation, government-backed arms-length agencies have built up sizeable lending portfolios with set benchmarks for Return of Equity (ROE). As profitable activities providing a return to government, the question of subsidy would seem to be largely obviated. However, subsidy *is* involved: mortgage-holders benefit from the guarantees provided by Treasury that enable cheaper debt to be borrowed, and from deferred costs associated with interest that would have otherwise been paid on the partner share. Furthermore, the equity share held by the partner ties up funds for which alternative uses could be identified where returns may be higher or less risky. The costs of covering those loans at the outset do have to be accounted for and thus negotiate prevailing budget constraints – regardless that repayment and redemptions will cover those initial subsidy costs, the servicing of that subsidy and indeed profit.

5.3.1 The question of middle class welfare

One question that often arises in the context of justifying public subsidy for shared equity relates to concerns tied to what might be termed middle class welfare. As has been discussed in the context of determining eligibility criteria for schemes, shared equity arrangements present a challenge for policy-makers since for the most part they cannot be targeted at those in greatest housing need, whether measured in terms of requiring access to shelter, or in terms of affordability constraint. Almost by definition, households who can consider ownership (shared or otherwise) have a greater capacity to meet their shelter needs than those who cannot.

The question revolves around the extent to which government assistance in helping households into homeownership moves beyond provision of shelter arguments to

[23] We do, however, acknowledge the increasing importance placed by Treasuries on quantifying social as well as economic benefits of schemes and initiatives claiming these wider benefits.

concerns regarding 'unfair' advantages provided to those recipients in the form of being able to enjoy the benefits of asset accumulation tied to owning (or part owning) a residential asset. Such arrangements present non-universal access to possible substantive windfalls at a later date where values rise and the property is sold.[24] Such concerns can be mediated through a series of counter considerations:

- Households at the margins of ownership have access to fewer subsidies than low and higher income households if they remain trapped in the private rented sector.
- The 'windfall' gain is based upon the equity stake held by the purchaser (i.e. their debt) upon which they are responsible for making repayments.
- On the sale of the property, the purchaser will be repaying the government's equity share back to the agency involved with house price appreciation.

Cost/benefit considerations tied to community equity models may avoid (to an extent) concerns regarding unfair access to potential gains, however present their own challenges. Since these models are typically tied to the provision of new housing and require higher initial subsidy levels, there will be greater imperative to protect that subsidy.[25] They also involve the partner holding onto a greater equity share, restricting the use of those funds for alternative, potentially 'better' uses. Returns on subsidy are tied, where the partner continues to bank that return in the form of reselling that property, again under shared equity arrangements, with a new household.

As such, benefits need to be considered in different ways to individual equity models. Rather than calculated in terms of rate of return as the loan is redeemed and eventually discharged, funding arrangements need to be structured in terms of building housing infrastructure, reduced social housing costs (on the basis that households are contributing to supply through sharing capital costs) and promoting responsibility and stability tied to ownership. Should a discount factor be applied as would be the case for long-term infrastructure programs? How would underlying gains from capital growth in the stock be captured and built into Treasury considerations?

5.3.2 Cost/benefit parameters for government, consumers

The above provisos noted, Table 11 presents, in broad terms, the costs and benefits that can be associated with shared equity arrangements for both government and potential customers, drawn from discussions held as part of this research. The factors identified primarily relate to individual equity arrangements, although many are pertinent and relevant across any form of shared equity scheme.

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[24] Although in cost-benefit terms the question of public subsidy may not come into play directly – the partner would have enjoyed 'gains' (less deferred interest) on their share – it is the differential access to opportunities to gain from a property-based windfall.

[25] It is economically feasible, and politically acceptable, to 'write-off' relatively small amounts tied to assisting access (e.g. First Home Owner Grants), certainly where returns through duties and levies can be assumed down the line and where the cost of claw back would not be efficient.

Table 11: Cost and benefit parameters for government, consumers

Cost to Government
→ Establishment/sinking capital for schemes. This is a cost if that equity injection is not returned to government at some later stage. If initial payments were repaid, then the cost would be the value of the best alternative use by government/ Treasury for the duration of the loan arrangement. → Costs tied to safety net or support provision. If this is a loan, then best alternative use of those funds need to be considered. If the payment is gifted, then the entire amount is treated as a cost. → Administration/operation/monitoring/regulation fees, or transfer payments to body set up/assigned administrative responsibilities. → Complexity of products can make administrative costs high relative to standard loans if not set up properly. → Cost of Treasury guarantees/return on equity benchmarks. → Cost of insurance/establishment of alternative vehicle for management of default and bad debt (LMI subsidy, development of a Risk Transfer Vehicle). → Deferred interest/discounted interest on the equity share held, assuming interest is not payable by the owner on this share. → Exposure to market and potential losses across the portfolio of debt held. → Potential disincentive to maintain property where owner is unlikely to more towards full ownership, or in weak market conditions. → Potential stimulus for additional First home owner bonus, stamp duty exemptions. → Significant reputational risk to government, political risk if things go wrong.
Benefit to Government
→ Capital appreciation of shared equity component in the property and which remains with government/agency over time. → Where the 'first' mortgage is also tied in with government lender (as is the case with HomeStart, Keystart), profits accruing from mortgage interest repayments. → Promotes entry into the housing market, providing benefit of transaction costs (e.g. where applicable stamp duty revenues, land title fees) down the line. → Stretching housing tax dollars, assisting a greater number of households. → Potential service delivery gains: reduced demand for Commonwealth Rent Assistance (CRA), freeing up social housing stock, alleviating public housing waiting lists. Transfer of maintenance costs to owner (where previously public housing tenant). → A sustainable framework for helping those at risk of falling out of homeownership, offering options to prevent/reduce the risk of foreclosure and repossession. → Alignment with wider policy and continuum of housing strategies: contributes to National Affordable Housing Agreement (NAHA) and complementary to other programs including the National Rental Affordability Scheme (NRAS). → Comfort of involvement of 'bigger government', control over regulatory activity. → Long term benefits from owners with assets, reducing the call on the public purse.

Cost to consumer

- → Loss of capital gains on proportion of equity held by partner at the time of sale.
- → Opportunities limited by criteria tied to the scheme (limiting the maximum value of property, limiting loan to ensure affordability of repayments).
- → Lack of flexibility in terms of principal mortgage component if tied to government lender (only a cost if terms are disadvantageous compared to offers available from a mainstream provider given customer circumstances).
- → Full cost of ownership, including responsibility for all bills and taxes. Responsible for all repairs. Renovations should be a neutral transaction in that costs incurred in making improvements typically taken into account in equity calculation.
- → Depending on design of product/scheme, interest may be payable on portion of equity held by partner (not the case in any of the current Australian schemes).
- → Any transaction costs tied to purchase of additional equity shares in property.
- → Increased costs associated with purchasing additional equity shares (change in market value less saved interest payments until time of purchase).
- → Possible limitations on capacity to move elsewhere in the market given the redemption of equity loan to partner.

Benefit to consumer

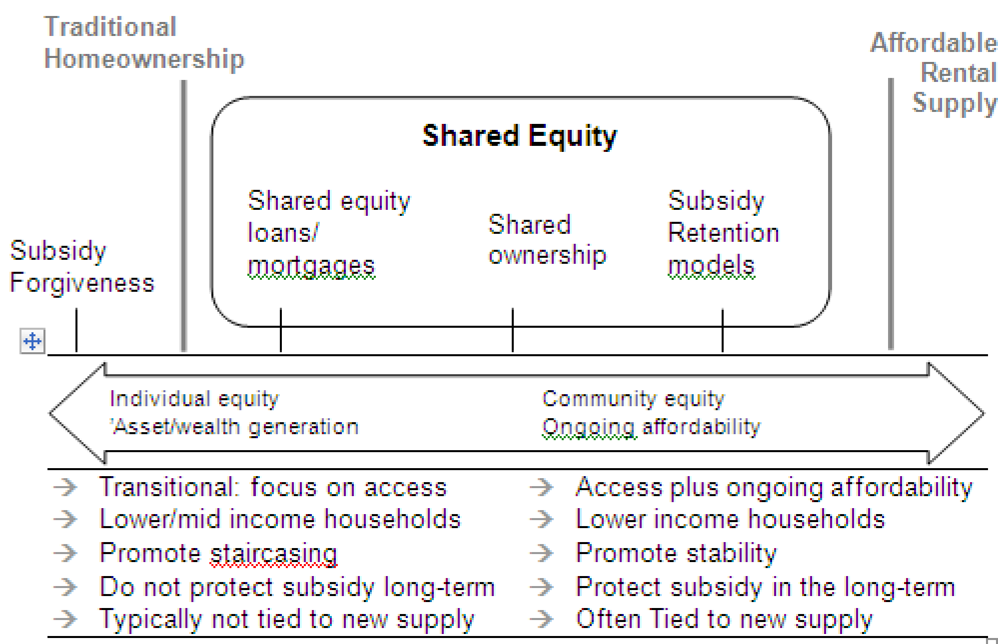
- → Minimal deposit requirement, bringing forward purchase opportunity.
- → Typically no, or very little, mortgage insurance costs.
- → Reduced home loan repayments (given that the size of the loan equating to the equity share is going to be smaller than a 100% mortgage).
- → Saved interest repayments on proportion of equity not owned (presuming the product/scheme waives these costs).
- → Opportunity to sink any additional income into non-property financial instruments, (although households are typically expected to buy further equity shares when able to do so).
- → Safety net/support provision through organisations' commitment to ensuring continued affordability (potential to extend term, potential to 'step down').
- → Extending borrowing capacity: access to a property of higher value than would be available through a normal loan. This provides access to opportunity for greater wealth accumulation (if one assumes that greater absolute gains will be seen – even when equity sharing at sale is taken into consideration – from a large capital base).
- → Where negative equity arises (dependent on product design), losses will be mitigated by partner having to shoulder their portion (or at least some) of the loss.
- → Crucially in the current financial context, access to mortgage finance on affordable, sustainable terms through the government schemes.
- → Ability/flexibility to choose whether to pay down interest bearing loan or buy back a portion of the share.
- → Ability to accumulate 'advance' funds on the interest bearing loan (thereby reducing interest expense) and commute as a lump sum to the equity loan when circumstances or market conditions are conducive to doing so.

5.3.3 Positioning the benefits of shared equity within wider policy goals

To a large degree, this overview framework acts to reinforce and consolidate prior assessments of costs and benefits of shared equity arrangements, and remains tied primarily to considerations focused on the transaction between government and borrower, and how that transaction can be justified (or not). It arguably fails to resolve more fundamental questions as to whether government should get involved in these complex arrangements. A one-off grant of $14,000/$21,000 in the form of FHOG/First Home Owners Boost could, for example, equate to similar levels of financial subsidy over time to underpin a shared equity arrangement, but is unquestionably easier to administer, does not come with the risks tied to debt, and has a broader, quicker reach. In which case, why bother? If private lenders are cautious of the instrument, are there broader considerations helping to underpin policy interest? In this regard, the case needs to be made for a more strategic take on the benefits tied to such arrangements.

Core to shared equity's potential is its connection to, and facilitation of, wider housing strategy goals which capture aspirations to improve social and economic outcomes and assist household mobility. Figure 11 reproduces the positioning and role of variant forms of shared equity arrangements within the transitional space between renting and ownership.

Figure 11: The role of shared equity at the renting-ownership transition



Source: Adapted from Jacobus and Lubell (2007)

Providing policy support to this transitional space within the housing continuum, shared equity can be considered, and its associated costs and benefits understood, within this broader framework of measures. It:

- signifies strategic intent in terms of whole-of-housing system policy interest
- offers a means of facilitating mobility and a targeted, sustainable approach to addressing affordability constraints between renting and ownership
- represents a strategic, sustainable framework rather than reactive response for assisting households at risk of falling out of homeownership

- → spearheads innovation in products/policies tied to accessing ownership, where the nexus between Government and private market operation is central
- → spearheads financing arrangements that can help expansion of affordable housing provision and an evolving role for the community housing sector
- → can provide an integral component within wider housing and urban renewal objectives, for example as one of a number of potential supply and financing measures tied to the deconcentration of large social housing estates and movement towards mixed communities.

In identifying the contributory roles that shared equity arrangements can play within a broader affordable housing/housing affordability policy framework, a number of commensurate risks inevitably arise. The co-ordination of interests and options at key sites within the housing system offers strong strategic direction, but risks becoming overwhelmed with interlinked requirements and responsibilities for delivery.

While innovative funding frameworks enable housing providers to reconsider their portfolios across a range of tenure arrangements, such flexibilities may increase exposure and dependency on market activities, and risk the effectiveness of any public subsidy becoming dependent on market context. For example housing associations in the UK have enjoyed increased flexibilities within their remit to provide shared ownership and market sale housing. Under particular market conditions, such activities will be profitable and indeed help cross subsidise the broader activities of the association. However, in a declining market, such activities may increase exposure to risks traditionally not part of their financing models (Whitehead et al., 2008).

5.4 Type, targeting and market considerations

The continued rationale for government interest in facilitating access to ownership, and how shared equity arrangements may be positioned within such assistance have been considered above. In this section, we return to core findings from the focus groups with potential consumers and housing market considerations, reported in Chapters 2 and 3, to draw up recommendations regarding the viability and appeal of this type of arrangement, the target groups for shared equity, and the wider impacts policy engagement may have on the markets within which such schemes operate.

5.4.1 'Individual' versus 'community' equity arrangements

Where do the two different types of shared equity arrangement explored in our research – 'individual' and 'community' – fit in terms of this positioning? To date, Australian initiatives such as First Start and Breakthrough have followed the individual equity model. While capital gains are shared at the time of sale/refinancing and thus subsidy recouped, such arrangements are unable to preserve affordability within the stock for future purchasers. By contrast, community equity arrangements enable retention of a greater share of equity by the partner and hence reduced entry and ongoing costs for the purchaser.

Both types of arrangement have a role to play as part of a comprehensive policy response at this transition point within the housing continuum. *They share similar policy drivers at root, but fulfil different functions. They also represent quite distinct consumer propositions.*

Our research with potential consumers would suggest that factors shaping the appeal of the two schemes, and how they might be positioned, are not simply variant forms of the same. They are not interchangeable, more or less appropriate given particular housing market contexts. Most participants distinguished between an arrangement

that helped them become a homeowner, and an affordable, secure housing option that was a 'good idea, but not for me'.

First and foremost, consumers are drawn to the concept of full homeownership, and for the large majority, opinions and expectations are framed against this benchmark. If they cannot achieve this, then they will consider the trade-offs involved in other options that may help them achieve that goal. Individual equity arrangements suggest a route map to *normal, full* ownership. Community equity arrangements, in terms of its characteristics of being tied to particular dwellings and involving a 'not-for-profit', 'trust' or housing association are perceived as for those whom outright homeownership is an unlikely prospect. Wanting a *helping hand,* rather than an alternative, intermediate tenure, was pervasive across income levels – even where the actual costs of full homeownership meant that community equity arrangements were likely to be more feasible.

As a result, individual equity models can be seen to respond to the trade-offs consumers may be willing to make, and provide a framework that can help people step up into 'normal' tenure arrangements rather than become potentially trapped in an intermediate tenure. Consumers may see complex financing arrangements as a trade off worth making provided the end result is perceived as straightforward. If that end product is also complex (as is arguably the case in community equity arrangements, certainly in the context of valuation), then the equation may become less acceptable. This is not to dismiss ongoing policy interest in community equity arrangements as part of the strategic mix at the renting-ownership transition, not least in terms of being able to provide a vehicle for affordable housing supply. It does however suggest that how these arrangements would be costed, and policy objectives understood and evaluated, would be on different terms.

5.4.2 Who should be assisted: lower or moderate income households?

The profile of households assisted through shared equity arrangements will alter over housing market cycles. As discussed in Chapter 3, the recent renewed interest in these arrangements in itself reflects affordability constraints within the market, not only for lower income households but for those on moderate, and towards median incomes.

If one looks at the customer profiles of government-backed agencies, their lending books display a broad range of income groups. For example, as at June 2008, 71 per cent of HomeStart customers (across all products offered rather than Breakthrough Loan customers only) had incomes less than the average weekly earnings and 28 per cent of metropolitan and 14 per cent of regional customers were low-income earners on salaries of less than $35,350 and $26,065 respectively. Of these customers, 42 per cent were relying on Centrelink payments as their main income source (HomeStart Finance, 2008).

As housing markets and interest rates move, and competition within the lending sector becomes relatively more or less attractive, customer profiles will change. Recognising this shifting customer base is crucial, as is ensuring that organisations can respond effectively in commercial terms to these changing contexts. Therefore issues for policy relate less to overly constrained eligibility criteria tied to meeting specific policy goals – for example helping social housing tenants purchase their homes – and more to ensuring flexibility for organisations to both respond to the market and act responsibly as determined by those market conditions. These principles are especially important in the early stages of building the lending portfolio. Commercial astuteness points to establishing this track record with a less risky customer base initially, and from the confidence provided, to then extend towards harder to reach groups. Equally, even

when established, in difficult market conditions organisations are likely to tighten conditions and retreat again to a less risky borrower profile.

Current government-backed initiatives, with eligibility criteria spanning both low and moderate income groups, can be seen as appropriate in terms of reach. It not only means that those organisations are able to sensibly respond in times of significant affordability constraint, but also ensures a more rounded customer profile and helps mitigate against being overly exposed to the risks inherent in any narrow and specialised focus.

This might appear to be at odds with specific policy goals, for example assisting social housing tenants into homeownership. However it can be argued that the commercially focused yet socially responsible nature of organisations such as Keystart and HomeStart provides a framework that actually helps improve the effective delivery of these very targeted policy aims: i.e. the benefits of arms-length operation not only helps to provide a viable vehicle for offering products to lower and moderate income groups more broadly, it perhaps also provides a stronger framework than programs that remain managed ‘within the policy line’.

Agencies also keep a close check of lending profiles vis-à-vis mainstream lenders, demonstrating effective targeting with minimal crossover. In one of the organisations’ recent market check, around 85 per cent of their clients would not have been eligible for a standard loan. If policy is seeking to facilitate ownership – as here – then it needs to work within the market. It can best do this where commercial acumen as much as ‘good policy’ drives those activities.

5.4.3 Influencing the housing market: fuelling demand or stimulating supply?

Another core policy concern relates to the impact of shared equity arrangements on the housing market. If they were untargeted and to be made widely available, there is clearly a risk that such mechanisms would simply add stimulatory demand-side pressures. Where the market faces supply constraints, the potential to drive up house prices obviates any initial benefit provided.

As discussed in Chapter 3, recent schemes have mainly allowed customers to purchase within the open market rather than being limited to new supply. The scale of these schemes to date has been small, and at any one time will only account for a minor proportion of overall housing market activity. Unravelling the potential impact of First Start and Breakthrough shared equity schemes in the Perth and Adelaide housing markets respectively in the past 18 months is difficult. It is possible that some sectors and locations within the market near the price maxima for schemes may have experienced extra demand side pressures. However given the numbers involved, any stimulatory effect is likely to be significantly less than seen with the return of the first home buyer to the market encouraged by the current, time-limited First Home Owners Boost.

Indeed, it would appear that the market has responded in a more balanced way, with builders in WA, for example, tailoring their products to reflect the criteria of schemes and marketing the use of First Start loans as an affordable financing option for the house packages on offer. This is cemented through further innovation led by these arms-length agencies in conjunction with respective state housing departments, and local developers to help provide frameworks for the provision of new supply that can be purchased on affordable terms through shared equity arrangements. As such, the schemes enable purchase within the existing market, but also help to promote the conditions and provide support for bringing on new supply.

A number of initiatives have been explicitly tied to new supply. Vicurban/Burbank Homes have a shared equity scheme available on a selection of properties across a number of new developments in Metropolitan Melbourne, typically in fringe/Greenfield locations. Tasmania's Homeshare scheme is also restricted to new supply (or existing Housing Tasmania properties), however the 'reach' of the product is facilitated through eligibility applying to all new build in the state, and coordination with a large selection of house and land developers who are making available homes suitable for the scheme.

There is a balance to be struck. Where schemes can encourage the market to build new supply, then this will assist in delivering wider policy gains in addition to assisting target households and groups into homeownership. However as our research with potential consumers has emphasised, and which leans preferences towards individual over community equity arrangements, products need to provide consumers with the opportunity to behave as a 'normal' homebuyer. This means being able to exercise choice, have options in terms of location, and provide mechanisms to reach full homeownership over time.

New build options are part of this, but being able to participate in the open market is important if shared equity is to be seen as an integrated rather than separate arrangement. If only tied to new build, and in particular house and land packages, then options may become skewed, for example, focused on Greenfield release family home markets. Again, this has limitations in terms of effective targeting in policy terms and also lender sensibilities in terms of not wishing to have their portfolios over-exposed in particular market segments and locations.

5.5 Realising the potential for shared equity arrangements

> 'There must be government commitment to facilitate the growth of the shared equity market and to provide an environment in which potential participants can obtain the necessary risk-return balance. Most fundamentally, development depends upon their being demand among both new entrants and more established households to be prepared to share the equity in their home'. (Whitehead, 2008, p. 11)

The future potential for shared equity arrangements has often been considered from an assumption that it is a question of getting the product right and removing barriers to the realisation of what should be, on paper at least, a 'win-win' situation. For government, this has meant looking at ways in which the private sector can be encouraged to play a greater role, and identifying ways in which long-term funds (such as institutional funds, superannuation) can be married to long-term debt (portions of equity held in properties). In the current financial context, a degree of reappraisal is inevitable. Expectations that the private sector can be encouraged to take on the additional risks (real and perceived) tied to innovative finance products such as shared equity, will be strongly tempered in the short (and probably mid) term.

However, bringing together public and private sector interests in sharing the risk-return balance continues to be an appropriate goal. Recent events remind us that this partnership is both necessary as well as beneficial, reiterating the valuable role that 'public' sector government-backed, arrangements play in providing a sustainable framework through market cycles. Even if the 'ideal' product were to exist, the role of government should not necessarily become less explicit.

It can be argued that partnership goals may be framed in terms of promoting mechanisms that:

- → Acknowledge the existing strengths provided by state/territory government-backed agencies (where they operate), offering a sustainable 'stepping stone' to mainstream housing finance, with necessary safety nets.
- → Enable the more effective interplay between government and the wider mortgage industry where strengths on each side are equally acknowledged especially at a time where the availability of 'prime' finance is likely to remain constrained in the short- to mid-term.
- → Avoid additional levels of complexity wherever feasible. While shared equity should not be treated as something that can be overly simplified, schemes should seek to reflect 'normal' operations and expectations as much as possible. This is not to quash innovation, but suggests that in needing to take a number of stakeholders along with it, developments are likely to have greater success when incremental.

In broader policy terms, it is not only about recognising that a continuum of strategies and approaches are required when taking a 'whole-of-housing-system' approach, but starts to understand how public and private sector arrangements can work together to *deliver* those strategies.

5.5.1 Acknowledge existing strengths provided by state/territory government-backed agencies

Given their role as the primary innovators in shared equity provision in Australia, the focus on state/territory government-backed agencies in this research is perhaps inevitable. As discussed in Chapter 4, despite their modus operandi being arguably less efficient (certainly in terms of profit margins) than their highly-leveraged private sector counterparts, and the shared equity arrangements in place somewhat 'clunky', we should take significant heart that the approach taken by these agencies in recent years has – when compared to the big scheme of things – been largely right, rather than largely wrong. As such, these arms-length agencies can provide a strong basis upon which greater synergies between public and private sector arrangements can be built:

- → Sound social, ethical and business objectives – tied to long standing state level relationships with government departments, lenders and development industries, and indeed their local customer base – have fostered a basis for trust and demonstrated the role they play in wider policy contexts.
- → Although operating as commercial concerns, they have done so under the watchful eye of their respective Treasuries. Agencies benefit from not being subject to the restrictive nature of ambitious investor expectations on return on equity, but nonetheless operate with the same financial rigor. Equally, distance from the direct policy line is crucial. If too close, competing funding priorities and demands are likely to come into play.
- → Given their state/territory based remit, they are able to recognise and respond to housing markets that exhibit significant spatial and temporal variation, and have had to operate within stretched markets without risking becoming a victim of, or simply fuelling, overheated prices.

These agencies can be seen to provide a transitional helping hand, with safety nets for those for whom the transition requires more ongoing support. They provide a framework for sharing the risk at the margins of homeownership, assisting customers who would not have been eligible for a standard loan, and within a number of years, helping to deliver a customer base with financial histories and some equity behind them, and therefore more attractive propositions for 'prime' lending arrangements. If

schemes are structured to encourage mobility to ‘staircase’, ‘step up’ (and if necessary, ‘step down’) they are likely to work better for *all* stakeholders involved.

Holding onto good customers is sound business practice, but getting people in and moving them on can also be seen as a strong and beneficial policy outcome. Positive outcomes can be measured in terms of the rate at which loans are discharged, subsidy recovered and customers move into ‘normal’, ‘prime’ arrangements with mainstream banks – and have a sustainable basis for doing so. Although the organisations tend to require borrowers to take out their mortgage with them, it is likely that the borrower would seek the flexibility enjoyed by standard loan holders when their circumstances permitted. Typically, the timeframes in which loans are held before redemption or remortgaging will be longer than had those loans been taken out with one of the large banks. Nevertheless, many customers who start out on shared equity arrangements are likely to be in a position to refinance onto a standard ‘full’ loan after a number of years. In so doing, they may choose to remain with HomeStart, Keystart or TIO, or decide to go elsewhere.

HomeStart works alongside BankSA, with their mortgage products marketed through branches of the mainstream lender. This is a mutually beneficial arrangement. Customers not eligible for one of the bank’s standard mortgages can be directed towards HomeStart. Passing on this opportunity, the bank may have ‘lost’ business initially, however, they retain a relationship with those customers over the years (since government-backed agencies cannot fulfil all banking needs – you cannot hold a current account, or save, through them). In time, they are well placed to appeal to this borrower if and when they come to refinance.

5.5.2 Encouraging synergies between government and private lenders

While the strengths and benefits of organisations such as HomeStart can and should be acknowledged, this should not preclude consideration as to how their operations may be further assisted, or greater leverage achieved, through encouraging synergies with private lenders and investors. Clearly agencies are already closely tied with the financial markets – they issue debt and borrow as other lenders – however, potential exists for greater involvement of private lenders. In general terms, this involves sharing information to build up a better understanding of product behaviour, risks and redemption profiles. It may also involve closer co-ordination at the time of establishing equity loan positions, or once a portfolio has been established, ensuring frameworks that offer an efficient means of selling down those assets.

Under Basel 2, lenders are required to set aside capital to cover the risks of their lending activity. The more risky the lending as measured by the probability of default (PD) and the loss given default (LGD), the higher the capital requirement: thus a 70 per cent loan to value (LTV) loan attracts a much lower capital weighting than a 90- or 95 per cent loan where the LGD is going to be much higher, reflecting the narrower scope for dealing with any difficulties without triggering actual losses. Government equity in the shape of the equity loan brings the LTV for the borrower down and thus reduces the capital charge, enabling cheaper loans to be provided. Nevertheless, agencies need to meet this equity position upfront, have it on their books, and take the risk. There are other ways in which the benefits of reducing the LTV can be enabled, for example in the form of government guarantees or incorporating public subsidy into a private product (see box 3).

Over time, such arrangements can be seen as a means for integrating shared equity provision into mainstream lender activity. This has the advantage of avoiding debt on government books and the risks attached to this, and is likely to encourage conditions where the potential for shared equity arrangements to act as a stepping stone are

maximised. However there is a risk that many of the underlying success factors tied to the operation of government-backed organisations would be lost, most importantly the *on-going relationship* represented through that debt position, which also provides the basis for socially responsible practice tied to assisting households into ownership.

Box 3: Public subsidy for private led schemes?[26]

At present, the risk-return balance limits the willingness of private lenders to be involved in shared equity arrangements. Is there an arrangement where those subsidies can be channelled into a financing agreement that does not add to public subsidy costs and that provides better expected returns and reduced risk for the private lender? For example, the first home owners grant could be complemented with funds from state (or Federal) government. This would need to be set at a level that provides sufficient incentive but that would not need to be recouped. Let's say that funding of around $35,000 was made available. This would not be paid to the purchaser, but rather paid directly to the shared equity financier.

As a result if the shared equity component was $80K, the financer would be funding $45,000 but get an asset worth $80,000 (taking into account the $35,000 subsidy) in current values. The level of risk to the financier is immediately mitigated, and returns potentially magnified. If the house sold is after seven years and capital growth of 4 per cent pa occurred, the financer would get a return of 12.9 per cent pa. If it sold after 12 years the return would be 9.1 per cent pa. Such returns would be potentially very attractive. Both parties arguably benefit from the arrangement:

→ The purchaser gets to share in the capital appreciation in direct proportion to their ownership and therefore their position at sale should allow them to keep up even if market values have increased.

→ Governments get to provide an upfront subsidy based on their own respective policy priorities and this is a one-off upfront subsidy that is not subject to market volatility. Governments also do not have to fund the whole shared equity position ($80,000) which provides more opportunity for home buyers to enter the market.

→ The shared equity funding would be separate to the first mortgage finance which could be provided by one or more entities including existing Government agencies.

Avoiding debt on the books also risks detaching responsibilities. The hypothetical arrangements outlined in box 3 above would not necessarily introduce the risks seen in the early 1990s when detachment meant that the retailers of low start loans did not have responsibility for those loans, however, there would be concerns regarding the possible loss of on-going interest and degree of input. A second strength of continued closer government engagement that may be lost in such trade-offs is tied to the value such organisations can play in terms of helping drive innovation in local markets. In this transitional space between renting and ownership, the case has been made in this research that shared equity is not a simple one-off subsidy transaction – there are more cost effective and far less complex grant mechanisms available – and it should be recognised as a longer-term investment and commitment.

5.5.3 Acknowledging complexity, but avoiding further complications

While the above considerations acknowledge that complexities involved with shared equity are actually part of the rationale for government engagement, there is clearly a good case not to further add to those complexities wherever feasible. Existing

[26] The figures for this hypothetical arrangement were provided by a state/territory government representative on the Project User Group.

initiatives essentially aim to reflect conditions and experiences within the open market and do so by seeking to 'normalise' the distinct characteristics of the products as much as possible. For example, the arrangements ensure that there are clear lines in terms of first call on the property in the advent of difficulties, and rights and responsibilities of the partners involved. Although shared equity arrangements *are* different, the aim is to minimise difficulties that may arise as a result of those differences.

Individual equity arrangements are more complex than a standard home loan and disrupt the traditional relationship between lender and borrower, but are arguably less so than seen with community equity arrangements,[27] where administrative, legal and valuation considerations reflect added degrees of variation from understood practice. Seeking to foster arrangements that are as 'normal' as possible is not to argue against innovation and the development of more 'sophisticated' products, but it does caution about the challenges involved with more complicated models. Thus there is a strong policy case for shared equity models that can help increase the supply of affordable housing and preserve that affordability in the long term; however, as discussed above, these models arguably demand equally sophisticated trade-off decisions in the face of added complexity. This is true not only for potential consumers, but also lenders.

5.6 Addressing a currently fragmented policy landscape

Supporting the role that government-backed, arms-length agencies play at the state and territory level raises a significant policy gap in those jurisdictions where such agencies are not in place. As noted above, most states and territories without a government-backed agency *are* moving forward with the provision of shared equity options. These have tended to be on a small scale and, being administered by housing departments, first and foremost 'policy led' rather than operated on commercial lines. While these models offer valuable arrangements and, certainly in the case of Tasmania's HomeShare useful insights into partnership working with a mainstream lender, they are unlikely to evolve and replicate the reach and scale seen in South Australia or Western Australia without further support.

Here, the question is not simply one of putting in place the provision of shared equity products, but developing frameworks that can help drive innovation with appropriate affordability and sustainability considerations at the margins of homeownership across a range of policy options. The ability to deliver more effective, integrated, 'whole-of-housing-system' policy requires commensurate financing vehicles that assist in the translation and delivery of those strategies. As has been seen in South Australia, advances in affordable housing policy have been assisted by the opportunities presented by HomeStart's capacity to drive forward innovative financing arrangements. If it is appropriate that such arrangements should be made available to target groups whether they live in Sydney, Perth or Brisbane – and a case can be

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[27] Although the model is not strictly a 'community equity' model as described in this research, the ACT Government's Land Rent Scheme highlights the challenges faced where legal provisions are reworked through the separation of ownership between property and land. In this model, discounted rent is payable on the land, which remains owned by government, and the purchaser pays for the dwelling built on that land, thereby significantly reducing entry costs.

In a report providing a professional review of the scheme (made publically available through a freedom of information request from the ACT Liberals to the ACT Government), Professor Brian Roberts notes that the separation of land and structure(s) built on the land gives rise to complex valuation issues, particularly since land values are likely to rise over time (to the benefit of government) while the dwelling structure may depreciate over time. Thus if equity gain is largely tied to land value rather than collective land-and-value gains (as is the case in many lower value suburban markets), the consumer proposition is clearly a difficult one.

made that would support fairness in terms of access across the nation – the core policy question arising focuses upon how that can be facilitated.

5.6.1 Endorsing existing and re-establishing state and territory schemes

One policy response would be to support existing state and territory level agencies and promote the re-establishment of arms-length organisations in jurisdictions where such arrangements are currently not available. The success of organisations such as HomeStart has been built on establishing and consolidating their role within the policy, market and lending contexts in which they operate, building trust and demonstrating their remit over time. This research has made a strong case for the value provided through engagement at this spatial scale, enabling local market responsiveness and institutional context to be recognised. This has enabled these agencies to establish a niche, yet influential, role within their respective jurisdictions.

A NSW or Victoria equivalent of HomeStart cannot be established overnight. It would be a bold and dramatic shift for governments in those states which suffered from the fall-out of the low-start loans saga to return to such models, and the level of commitment required to re-establish those frameworks is significant. Nevertheless, acknowledging those difficulties should not instantly close down debate in this regard. There should be few regulatory impediments for government-backed agencies to be built up again in those jurisdictions where they have lapsed. The primary challenges will be political and financial. Although the spotlight is placed on the states, close cooperation, leadership and assistance from federal government will be central in terms of sharing initial risks and ensuring that policy frameworks at Commonwealth and state level are coordinated.

5.6.2 A 'national' shared equity scheme?

Alternatively national reach could be fostered through a new scheme overseen and administered from Canberra. This would present an equally substantive commitment. It would risk replication with initiatives already in place at the state and territory level, and would require frameworks that ensured that variations in market dynamics, affordability and consumer interest across the country could be accommodated. The strengths of state/territory schemes in this regard would be hard to reproduce: it is unlikely that sensitivities in terms of understanding local needs, responsiveness to market dynamics and integration with wider housing (and indeed social and economic) policy objectives could be fostered through delivery at this scale.

Rather than starting from scratch, the potential to extend the operations of existing organisations – established through Housing Acts in their respective jurisdictions, tying their remit, and product reach, to those geographies – to states where shared equity arrangements are not available could be explored. How such arrangements relate back to the policy line, to Treasuries in terms of guarantee provision, shouldering risk, and flow back of any profits raise important questions. For the existing agencies themselves, there are significant risks tied to such expansion, not least in terms of being unable to replicate key success factors at this scale.

5.6.3 Engagement at all levels of government

While a nationally *administered* shared equity scheme is not advocated, this clearly does not preclude the important role for more structured Federal commitment. Indeed, clarification of support is required, and may be provided, on a number of levels:

→ Demonstrating long-term commitment to shared equity arrangements, identifying the contributory role appropriately targeted schemes can play in helping deliver the aims and objectives of the National Affordable Housing Agreement (NAHA).

- That commitment needs to demonstrate involvement over market cycles, and the different conditions and challenges that operating over a cycle involves. In this regard it is not only about identifying shared equity as a means of assisting access to ownership, but also a mechanism providing tenure mobility.
- Fostering an environment that balances nationwide consistency and certainty in terms of taxation, reporting and regulatory arrangements on the one hand, and helps to build and support local market responsiveness and flexibility on the other.
- Fostering transparency and sharing of information – *between governments, private lenders, and investors* – as schemes gain insight from redemption profiles, rates of staircasing, and flows of assets and liabilities in order to better understand the nature of shared equity products. Working within both institutional and lender requirements, governments and lenders need to look carefully at the Basel 2 consequences in the structure of any schemes advocated.

One route might explore an umbrella 'guarantee' or support agreement under which different arrangements (existing or re-established government-backed agencies, not-for-profit, or indeed private lender-led) can be accommodated. If a case is made for underpinning support for state/territory-based activity, then a key role for federal government may relate to helping share some of the risk, and mitigating institutional caution, in re-establishing such agencies in states. This may involve provision of supportive frameworks between federal and state Treasuries in the establishment phase of new agencies until they reach scale and establish their own momentum.

A national framework in support of financing arrangements would also help establish a viable scale of activity, help spread location risk across different housing markets, and enhance the cost effectiveness of shared equity products. This could include the provision of a secondary market function with Canberra buying in state/territory equity loan assets and acting as a conduit to achieve greater certainty before selling them down to investors in the wider market. Such a vehicle might make it easier for those jurisdictions currently not active to engage with a shared equity program.

As well as a 'top down' commitment, coordination between all levels of government to address legislative or institutional barriers to sound innovative practice is required. Recognising that implementation and delivery of policy requires effective partnership working from Commonwealth to LGA (and indeed to not-for-profits and developers), points to the need to facilitate more integrated approaches if a strategic and sustainable response is to be fostered. The lessons to be learned from emerging models such as HomeStart's partnership with the City of Salisbury, and the policy and governance frameworks required to support them, need to be shared widely.

5.6.4 Final considerations

Shared equity arrangements should not be regarded as the panacea for addressing all housing affordability constraints faced by lower and moderate income households. However, they should be seen as an integral component of a range of policy responses to the challenges and opportunities presented at this point in the housing continuum. Where appropriately targeted, they can transform people's lives for relatively little or no subsidy in the long-term. Moving towards a 'whole of housing system' approach, governments will require structures – including financing structures – that facilitate delivery of strategic objectives for mobility between tenures. While success will be dependent upon continuing dialogue between policymakers, lenders, investors and potential customers, recent financial events allow governments to reassert their involvement, and contribution to innovation, in this space.

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www.keystart.com.au/key/home.htm

ownhome.burbank.com.au/packages.php

www.efm.info/index.php?v=Home

www.territoryhousing.com.au/home_ownership

www.tiofi.com.au/wps/wcm/connect/tio/website/Home

APPENDIX: FOCUS GROUP TOPIC GUIDE

General discussion about housing, current situation, barriers to ownership

→ Current housing circumstances
→ How long have they been looking to buy?
→ Buying on own/in a couple – different perspectives between partners?
→ What barriers have they been facing – deposit? Prices simply too high?
→ Understanding of the local housing market

Seeking finance

→ Experience with banks and lending agencies
→ Experience of trying to get a home loan
→ Understanding of other forms of 'innovative finance'

Introduction to 'Firsthome' or 'Yourhome' scheme (rotate)

→ Points of clarification.
→ Initial views on advantages and disadvantages.
→ Relative attractiveness of shared equity vis-à-vis alternative innovative schemes?

Discussion

Sharing equity

→ General understanding.
→ Preferred distribution of equity shares between purchaser and partner.
→ Trade-offs in entry, repayment costs versus equity accrued by the household.

Partnership arrangements

→ Preferred partners in relationship.
→ Role and nature of relationship with partner.
→ Administration of schemes: government department, government financier or mortgage brokers.

Living with shared equity

→ Flexibility – upward and downward staircasing arrangements.
→ Understanding of costs associated with buying additional equity shares in the property.
→ Is your home at more risk under such arrangements?
→ Should you be paying anything towards the portion they do not own – rent, interest, straight equity share or disproportionate equity share at time of sale?

Moving On

→ How improvements, renovations should be valued and accounted for in equity sharing arrangements.
→ What happens under shared equity arrangements at time of sale?
→ Issues of constraint/no constraint on sale.

In the open market or tied to supply?

→ Views on products tied to supply versus operation in the open market.

Targeting

→ Who should be benefiting from shared equity opportunities?

→ Should there be a limit to the amount of that benefit?

→ The relative importance of schemes preserving affordability versus schemes which maximise opportunities for equity gain.

Final thoughts – sum up discussion of advantages/disadvantages

AHURI Research Centres

Queensland Research Centre

RMIT Research Centre

Southern Research Centre

Swinburne-Monash Research Centre

Sydney Research Centre

UNSW-UWS Research Centre

Western Australia Research Centre

Australian Housing and Urban Research Institute

Level 1 114 Flinders Street, Melbourne Victoria 3000

Phone +61 3 9660 2300 Fax +61 3 9663 5488

Email information@ahuri.edu.au Web www.ahuri.edu.au