The Best of Three Worlds

Mutual Home Ownership combines housing affordability with equity and fairness

By Michael Lewis and Pat Conaty

As this article hits the airwaves, a brand new housing model is seeing the light of day. Devised to help scale up affordable housing solutions in the cities of England and Wales, the first Mutual Home Ownership Society (MHOS) will celebrate a sod-turning in Leeds in December 2011. They call the development "LILAC" (low Impact Living Affordable Community), an apt description for an urban eco-village that promises convivial, multigenerational living in high-efficiency, low-carbon co-operative housing. And affordable too: its unique structure accommodates a mix of income groups – not an easy thing in cities where land-flipping drives property values up and affordability down.

Take Michael here, for instance. Were he to try and buy the little 900 square foot, 2-storey apartment where he lives in Vancouver, B.C., he would have to come up with at least $530,000. Five years ago it was $300,000. Derek, a buddy of his who lives on the street, laughs, "I chose music over shelter years ago; I could not afford to live in an apartment and do what I love!"

Mutual home ownership is a fascinating stratagem designed to leverage the advantages of three very different models, all of which have been around for the last 40-100 years: community land trusts (United States), shared equity tenant co-operatives (Sweden), and the vision of the Letchworth Garden City (England). The result could well become a generative 21st-century model of fair and sustainable housing.

Community Land Trusts (CLTs)

CLTs ensure that a $100,000 property does not double in price every five years. In the U.S. where the model has advanced the furthest, CLTs are attracting more and more attention for three reasons: they preserve affordability in perpetuity; they preserve taxpayer investments in low income housing; and they have super-low incidences of foreclosure.

Why? It is simple, really! First, the ownership and control of land is separated from the ownership and control of the buildings on that land. The land is held outside of the market in a trust that is legally bound to preserve the land for affordable housing. Second, when they buy a house on CLT land, homeowners agree to a resale formula which allows them to make a modest gain in equity, but never a windfall profit.

LILAC hopes to have 20 homes and a common house complete by mid-2012, integrating co-operative community with ecological design and long-term affordability. The .7 hectares, the site of demolished primary school, offer plenty of heat and light for homes that minimize carbon emissions by means of a prefabricated strawbale building system, Modcell. Artist's sketch courtesy of White Design.

It is a powerful model. In Burlington, Vermont the Champlain Housing Trust has about 2,000 housing units which are now permanently affordable. That makes a big difference in a town with a population of only 40,000. (See "Affordability Locked In: Community land trusts – good news for households, communities, & taxpayers," *i4*, November 2, 2011.)

Sweden's Tenant Ownership Co-operatives

Tenant ownership co-ops differ in several ways from the housing co-operatives common in Canada. Under this Swedish model, the co-op owns the land and the building and grants occupancy rights to the co-op's apartments to the member tenants under the terms of a member's agreement. The members are also voting shareholder-owners of the co-op. Members also have a limited equity stake (typically 30%) in the value of the apartment they occupy. They buy this stake when they become a member and sell when they leave.

It is big – tenant ownership co-operatives comprise 18% of Sweden's national housing stock, in fact. One of the main reasons is that nationally they have created two key co-operative development organizations – the "mother" or secondary housing co-ops, HSB Riksförbund and Riksbyggen. Both help new co-ops to get going by mobilizing savings and by helping to organize other low-cost financing from additional bank loans. The "daughters" are the 5,500 primary tenant ownership co-ops. They are locally based, manage their own affairs, and get help from the "mothers" as needed for further development.

Finance is a mix of down payments (often personal savings and a personal loan – typically 30% of cost) on the part of the tenants, and bank financing (a corporate loan to the co-operative). When members leave the co-op, they sell their equity share to new members. In this way, people can earn a limited equity stake in the value of their home. HSB and Riksbyggen assist the daughter co-ops in managing the sale of the occupancy rights and the equity stake when a member departs.

In some urban areas with high land values, like Stockholm and Gothenburg, housing price inflation has become a problem, at least for lower income people. They can no longer afford to join a tenant ownership co-op. Restrictions on the sale price of members' limited equity stakes were removed by government deregulation of the housing co-op sector in the 1980s. This allowed the value of occupancy rights to float in a free market for member's equity stakes. Without a re-sale formula such as the CLT model provides, the Swedish model in some areas has moved upmarket to become the preserve of people with higher incomes.

The Garden City of Letchworth

This third inspiration to the MHOS designers dates back to 1899 when Ebenezer Howard established a "co-operative land society," First Garden City Ltd., to raise initial share capital of £20,000. His vision was to use the money to build new cities where the land was owned collectively. Letchworth, Hertfordshire, 50 km north of London, was launched in 1903. In 50 years its population grew to 33,000 and it thrived for a short period after that. By holding the land (5,600 acres), the co-operative land society was able to capture lease income from the land, from commercial buildings, and from a variety of social enterprises it owned, and continuously reinvest that money in community improvements. Residents were engaged in a mutual benefit system of unprecedented scale. Living was affordable, convivial, and people had what they needed close by.

In 1961 a group of corporate raiders and financiers attempted to take over the land, demutualize the organization, and break the back of the "co-operative land society." The national government successfully fought off the

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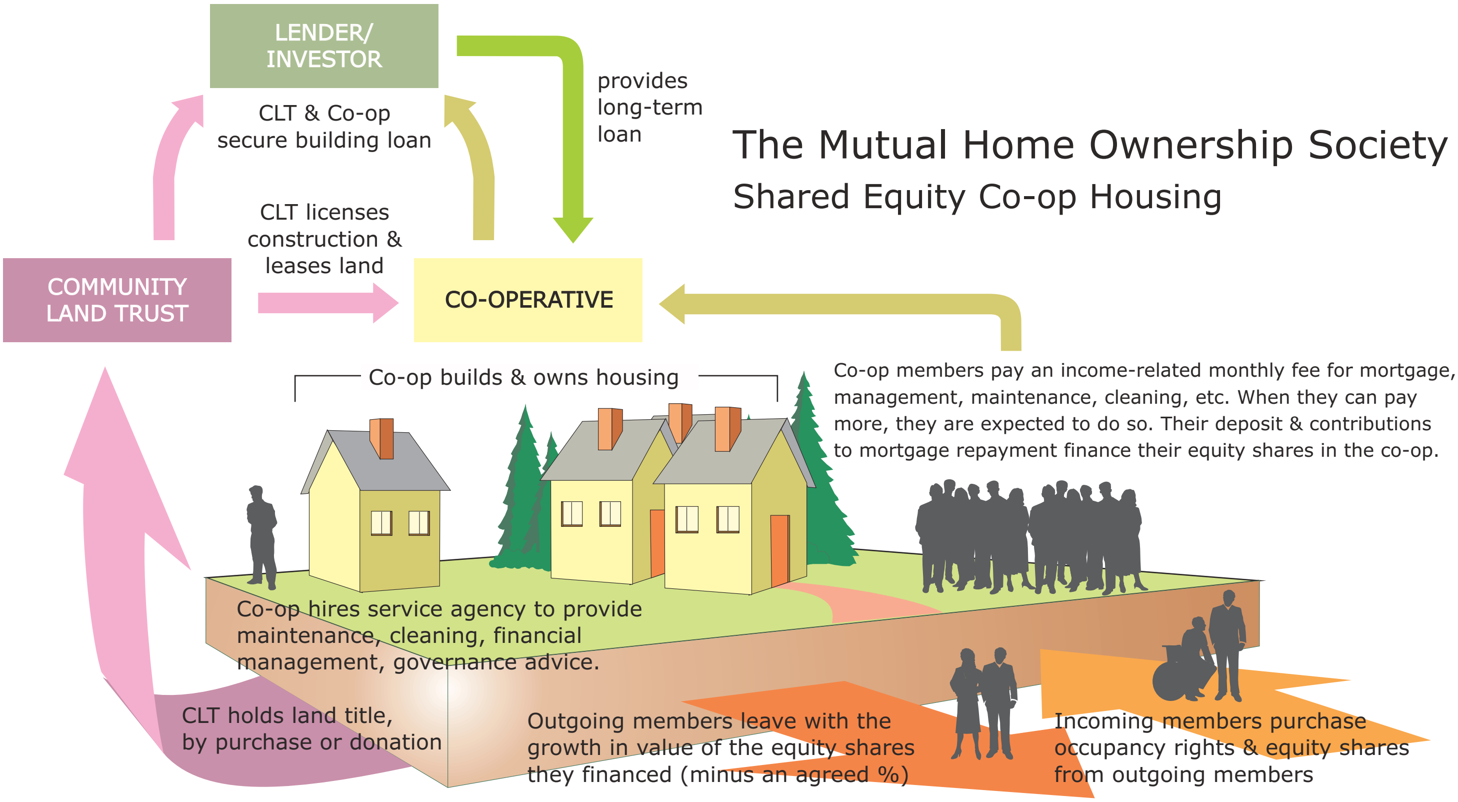
Garden Cities were to separate residential from industrial areas, feature many trees and open spaces, and be surrounded by belts of agricultural land. Payments for community services (rates) plus lease payments (rents) would create revenue for the co-operative and returns for its members. At Letchworth (left), cottage building competitions provided a venue to experiments with pre-fabrication, home garden plots, and new building materials. Photocredit: Kingsway Real Photo Series. Photo courtesy of Margaret Pierce.

The Mutual Home Ownership Society

Shared Equity Co-op Housing



Source: Lewis and Conaty, *The Resilience Imperative* (New Society, 2012)

onslaught, but victory came at a cost. The co-operative ownership of the land was transformed into public ownership. Then in 1995 it was changed back to a tax-exempt mutual structure and the land assets transferred to the new Letchworth Garden City Heritage Corporation (with a legal structure like that which Ebenezer Howard established in 1903). Essentially a CLT, this new "co-operative land society" has regained a number of land assets with 999-year leases.

Many of the homes were established with 99-year leases, however. The 1967 Leasehold Reform Act gave owner-occupiers in the U.K. the right to buy their lease at an affordable price. As a result, as the 99-year leases come up for renewal at Letchworth, residents are purchasing the properties and, following the logic of the real estate market, reselling them at a significant profit.

The MHOS Model

How to combine the best features of each of these models while avoiding their respective weaknesses – this was the puzzle Pat Conaty of the New Economics Foundation set out to solve with a team of researchers. Their novel solution was the MHOS, and it has since been championed by CDS Co-operatives, England's largest co-operative housing service agency, and its CEO, David Rodgers.[1]

As the diagram shows (above), the community land trust is central to the MHOS model. The trust owns the land and holds it for the purpose of preserving affordability in perpetuity. The trust issues a head lease to a tenant ownership co-operative which enables both the land trust and the co-op to organize the financing, with help from CDS. The tenant ownership co-op is then responsible for getting the actual construction completed with support from an expert development agent, a service which CDS also provides.

The eventual mortgage that pays for the build cost is held corporately by the co-op. Like the Swedish model, member-owners lease their units from the co-op. One prerequisite is a deposit of 5%-10% which is converted into equity shares in the co-op. Thereafter equity shares are also funded through members' rental payments. These payments, the asset and the land security provided by the trust, and the co-op's projected lease income together form the basis for financing each project. The pooling of resources into a single mortgage package helps reduce the cost of financing, which is an important contribution to affordability. (In the U.K's current risk-averse market, individual mortgages are especially hard for prospective home owners to come by.) Another cost savings flows from the assignment of equity shares and occupancy rights by members. This eliminates the legal and other closing costs that are part of buying and selling houses.

Once construction is complete, the co-op issues 20-year renewable leases to members. They can stay as long as they want, so long as they meet their obligations. One of the most important obligations is to make lease payments calculated at 35% of monthly household income, after taxes and deductions. If my household's take-home income is $1,500 per month, we will pay $525. Were we earning $5,000 per month, we would pay $1,750 per month for the same unit.

This seems fair and equitable. (It's a formula widely used by co-ops in Canada.) However, the designers wisely found a way to recognize the higher contributors. This is where the shares come in. Everybody pays the deposit up front. These become shares, with a face

Résumé : Le meilleur de trois mondes

Pat Conaty de la New Economics Foundation a une nouvelle façon de rendre le logement plus abordable au Royaume-Uni. La Mutual Home Ownership Society (MHOS) [Société mutuelle de propriété domiciliaire] combine les avantages de trois stratégies. Une community land trust [fiducie foncière communautaire] est propriétaire du terrain et le loue à une tenant ownership co-operative [coopérative de locataires-propriétaires]. Avec l'aide de la fiducie foncière, la coopérative négocie une hypothèque avec un prêteur. Ou bien, des emprunts d'investissements de logements mutuels pourraient être vendus pour financer l'édifice, tel que ce fut le cas de Garden City à Letchworth il y a 100 ans.

Lorsque la construction est complétée, la coopérative émet des baux renouvelables aux membres-locataires. Une de leurs responsabilités est un paiement de loyer calculé à 35 % du revenu mensuel du ménage, après impôts et déductions. Ces paiements et un versement de 5 à 10 % leur donnent droit à des actions de participation de la coopérative. Les ménages qui font de plus gros paiements de loyer obtiennent plus d'actions. À mesure que la dette de la coopérative diminue (et si la moyenne de revenus des membres augmente dans le temps), la valeur des actions augmente.

Les membres qui quittent la coopérative partent avec la croissance dans la valeur des actions qu'ils ont financées (moins un pourcentage convenu). Les membres qui arrivent achètent des droits d'occupation et des parts des membres qui quittent la coopérative. Une formule de revente dans le bail assure l'abordabilité à long terme de chaque logement.

Les MHOS sont de bonnes nouvelles pour les municipalités où le logement devient non abordable pour de grands nombres de résidents, incluant plusieurs employés du secteur public. Si les promoteurs de MHOS peuvent acquérir du terrain à des coûts en deçà du marché, ils peuvent par la suite offrir un investissement très sécuritaire aux prêteurs ou aux investisseurs sociaux. Ils peuvent améliorer la propriété à long terme et attirer des membres-locataires tant avec du logement à faible coût que la perspective de créer une valeur nette – sans mettre en danger l'abordabilité des logements. LILAC, la première MHOS de l'Angleterre, est actuellement en construction dans la région du Leeds.■

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value at their issue date of £1,000 each. As the corporate debt goes down and as (or if) average earnings rise over time, the value of the shares goes up. Since the lease payments are what pay down the debt, those who pay higher lease rental charges finance more equity shares. The designers also learned from the Swedish experience and built a re-sale formula into the lease to ensure long-term affordability. That is why equity share value is linked to average earnings.

Lastly, co-op members democratically control the management and the maintenance of their homes. They jointly organize housing repairs and control management and services. As LILAC demonstrates, low or zero-carbon housing solutions can be planned and implemented, including combined heat and power systems, photovoltaics, and (perhaps in the future) electrolytic power generation from co-operatively-owned hydrogen fuel cells, potentially the cleanest fuel on the planet.

A Closer Look at Mutuality & Equity

Those are the basics of the model. Now let's look more closely at the equitable mutuality it features. The table below illustrates how Mutual Home Ownership provides for equitable lease rates based on income level, and how lower and middle income members can earn limited equity returns as well.

To keep things simple, the table below applies the model works to a 2-bedroom household occupied by two working adults living either on their own or with one to two children. The income figures are aggregated for both earners and net of U.K. tax, pension, and other wage and salary deductions.[2]

Table: Mutual Home Ownership –
Monthly Costs (£) and Equity Shares for 2-Income Household

1. Total Net Household Income	£14,406	£16,688	£18,845	£23,108	£26,318	£32,738
2. 35% of net household income for housing costs	5,077	5,841	6,596	8,088	9,211	11,548
3. Less revenue costs payable for all members						
(i) Management	33	33	33	33	33	33
(ii) Maintenance	53	53	53	53	53	53
(iii) Service costs	18	18	18	18	18	18
4. Net monthly payment for corporate mortgage loan repayment	319	382	445	570	663	850
5. Capital value of corporate loan serviced	64,336	77,190	89,892	114,997	133,900	171,707
6. Number of equity shares funded by monthly payment	64	77	90	115	134	172
7. Add equity shares paid as 5% deposit	7	9	10	13	15	19
8. Total equity shares owned	71	86	100	128	149	191
9. Monthly cost of each additional equity share	4.95	4.95	4.95	4.95	4.95	4.95

In the heart of London, CDS Co-operatives has recently completed the Lithos Road Housing Co-op, which includes 13 rental units and nine shared equity units. In the latter, after the example of tenant ownership co-ops in Sweden (and unlike Canadian housing co-ops), the tenant-members build equity in the co-op through their monthly payments. This mixture of rental and shared equity is how MHOS are likely to function in big cities. Photo courtesy of CDS Co-operatives.

The key is the monthly payment (line 4) and the equity shares funded and "owned" by the member (Line 8). The corporate debt that a leaseholder services through his/her lease payments or deposit is progressively converted into equity shares. As members service the debt of the co-operative at different levels (because their payments are income-related), it is fair that they "own" units of equity, represented as their household's shares in the mutually-owned housing assets. The net value of the member's equity shares increase in value as the collective corporate loan is repaid and in line with the increase in average earnings over time. (This assumes that average earnings increase. If they do not, equity share values could fall.) Line 5 shows the smaller and larger portions of debt to be repaid by members with different levels of income.

A resale formula permits a modest return on the sale of equity shares. The following example of a resale formula assumes an annual increase of 4.5% in household income (i.e., an annual rise of 3.5% in the Retail Price Index plus a growth of 1% in real earnings.) In ten years this example would yield members a net equity value (net of the outstanding corporate loan balance) as follows:

- 71 shares = £13,314
- 86 shares = £16,271
- 100 shares = £18,919
- 128 shares = £24,217
- 149 shares = £28,190
- 191 shares = £36,136

Scaling Up Mutuality

Financing is key – for land acquisition and for mortgages. With the growing interest among social investors and pension funds in longer term, safe, and performing assets, there is much to recommend this model.

Firstly, if MHOS developers can purchase land at below-market value with support from national governments or local authorities, investors can be offered a good level of security on a loan-to-value basis (the ratio of the asset value to the corporate loan); the land at less than market value providing the asset cover required by the lender/investor. This is welcome news to municipalities where housing is growing unaffordable to large numbers of residents, not least those in key public sector jobs, including teachers and fire department employees. The municipality that owns land or has leasehold land coming up for renewal would do well to use these as opportunities to jump-start and expand on the MHOS model.

Secondly, the Co-operative Housing Finance Society Ltd, established by CDS, can provide a 1-year interest guarantee, an additional level of security. In addition, the national Community Land Trust Fund can assist with initial risk financing costs and secure additional financing for the construction financing phase. Broadening the current scope of loan guarantees would be helpful and CDS Co-operatives is working with financial advisors and lenders, including the Co-operative Bank and the Co-operative Group, to determine the feasibility of establishing a £200 million lending facility to support new MHOS projects. The Welsh government has just announced a project to work with CDS to develop MHOS across Wales in the next few years.

Thirdly, MHOS can be funded corporately either by bank lenders or through mutual housing investment bonds. The latter can offer a secure rate of return for ethical, municipal, trade union, or other types of social investor. Currently CDS is using this means to try and secure 40-60 year mortgage finance from pension funds.[3] This is much like the strategy (a mix of long-term mortgage finance below 4%) which Letchworth employed to build the Garden City a century ago.

In summary, Mutual Home Ownership is affordable because:

- lease payments are a set ratio (35%) of net household income.
- lower-income members can acquire equity shares. (In ten years the equity available to a low-income member is almost equal to their annual income.)
- members can buy more shares as their incomes rise.
- transaction costs are reduced. Properties are not bought and sold; instead, equity shares and occupancy rights are exchanged by assignment.
- over the longer term, borrowing costs should be cheaper as longer term financing is secured from pension funds.
- the linkage to average earnings helps reduce risk and maintains the affordability of the home.[4]

You've heard of things that offer "the best of both worlds." Mutual Home Ownership combines the best of three – community land trusts, tenant co-operatives, and co-operative land societies. The model keeps housing permanently affordable while giving current member-tenants incentives to maintain their dwelling and to contribute as much as they can to paying down the collective debt. As the LILAC Ecovillage shows, the model encourages environmentally sustainable housing, which is proving easier to finance. Collective mortgages can secure interest rate discounts and thereby invest in renewable energy measures and higher levels of thermal insulation. Active citizenship and community engagement are invited in two arenas, the tenant ownership co-operative and the community land trust. Quite simply, it is a model that manages to recycle its benefits from one generation of occupants to the next. i4

References

[1] See P. Conaty, Johnston Birchall, Steve Bendle, and Rosemary Foggitt, "Common Ground – for Mutual Home Ownership" (New Economics Foundation and CDS Co-operatives, October 2003).

[2] Data in this indicative table is drawn from information provided by David Rodgers of CDS Co-operatives.

[3] David Rodgers, "Mutually Beneficial," in *Ground breaking: New ideas on housing delivery* (London: Shelter, June 2009), pp. 34-37.

[4] See David Rodgers, "New Foundations: Unlocking the Potential for Affordable Homes" (London: The Co-operative Party, January 2009).

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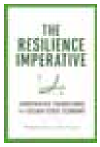

This text is an excerpt from *The Resilience Imperative: Co-operative Transitions to a Steady-State Economy*, by Michael Lewis and Pat Conaty (forthcoming, New Society Books, 2012). It explains how we can power down our economies to a more local and sustain-able level and thereby meet the challenges of climate change and rising energy prices. *Click here to pre-order!*

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"The Best of Three Worlds" is part of the *i4* special series "Housing We Can Afford," concerning the role of the social economy in resolving the growing shortage of affordable housing. The series is sponsored by the BC-Alberta Social Economy Research Alliance.