A Right to Co-op for London's Private Renters

A proposal and feasibility study: issues for consideration.

By Tom Chance and Samir Jeraj, October 2018

Summary

Londoners don't get a fair deal if they rent privately. The Mayor has acknowledged this in his Housing Strategy, but has not addressed some of the key problems with the private rented sector. In particular, his strategy offers renters little hope of gaining more control over their home, and even of owning it themselves, or with their flatmates.

A Right to Buy for private renters has been proposed in the past, most recently by the think tank Civitas in June 2016[1]. In this report, we set out the policy context and practicalities of such a policy in London. Two flaws we discuss are that it would not benefit most renters on medium and lower incomes, and that it would reinforce the perception that ownership is a better tenure than renting.

In response to these, we also set out a sister proposal for a Right to Co-op. This would enable renters to take control of their homes by transferring ownership from the private landlord to a co-operative. They could either run the home as a co-op themselves, optionally contracting a secondary co-op to provide them with governance, management and maintenance services. Or they could opt for an existing co-op to take over their home.

Policy context

The Mayor's Housing Strategy sets five priorities, of which two are a fairer deal for private renters, and high quality homes in inclusive neighbourhoods.

To achieve the latter he proposes to give Londoners the means to shape housing development through support for the Community-Led Housing Hub.

Groups and local communities that want to build or renovate homes will benefit from technical support and access to GLA housing funds. He sees Londoners having the capacity to take a lead in solving their own problems.

But to improve the private rented sector, the Mayor's focus is on regulations, voluntary agreements and council-led enforcement. For example, he pledges to "encourage consistently good standards in London's private rented sector by enabling councils to make better use of their powers", and to consider "reforms that enhance security of tenure for renters, reduce discrimination, improve the evictions process and dispute resolution".

We propose that the Mayor could join the dots between these two priorities and initiatives, to help Londoners take control of their own rented housing by supporting new renter co-operatives and calling for a Right to Co-op for private renters, as part of a wider private renter Right to Buy package.

Problems with the private rented sector

Renting privately is now the most common tenure in London, overtaking owners with mortgages in 2016. Where the tenure used to be seen as a temporary stage in a young person's life after school and university, more than one third of private renting households now have dependent children. Barely half of private renters are satisfied with the tenure[2].

Private rented housing is often poorly managed. One in twenty renters report having rented from a 'rogue landlord' in the past year[3], and one in three private rented homes fails to meet the decent homes standard. Homes in multiple occupancy (HMOs) and other private-rented homes are also increasingly being used to house people in housing need, but without the necessary professional housing support and management. A report from Islington Council found evidence of poor management in 68% of HMOs they surveyed[4].

Options for private renters are few and far between. Most have incomes too high to make them a priority for our constantly-eroded stock of social housing. Four in five have a household income below £50,000, making it unlikely that they will be able to buy a home on the open market or even – in many parts of inner London – one of the relatively small numbers of shared ownership homes. Those on middle and lower incomes are disproportionately more likely to have moved in the past year, some out of choice and many due to rent increases or bad landlords[5].

Private renting is not a happy place for many Londoners.

A driver of inequality

The tenure also entrenches wealth inequality, which is twice as high as wage inequality or household income inequality[6].

The poorest fifth of Londoners carry £5,000 in property and financial debt, while the wealthiest fifth sit on an average of £700,000 in property wealth, accounting for more of their wealth than their pensions, physical assets or other financial holdings[7].

Much of the public debate around this topic has focused on the impact on access to home ownership, however research indicates that access to wealth means better education and employment[8]. Those who are in households with little or no wealth are less likely to see those improvements in education and employment. 15% of UK adults have no or negative wealth.

Our proposals would not solve all of these problems in isolation. For example, a programme to retrofit all existing properties to high energy and water efficiency standards is needed, as are improvements to the regulation of the private rented sector. But our proposals would provide private renters with one route out of these problems for themselves.

A Right to Buy for Private Renters

The Government continues to support a legal right for council tenants to buy their home, and has worked on a voluntary deal to offer the same to housing association tenants.

We propose that the Government consider a similar right for private renters.

As proposed by Civitas[9], renters would gain a legal right to buy their home off their landlord at a discounted price determined by an independent valuation.

They could gain this right after occupying a property for 3 years – something made more possible by the replacement of the current Assured Shorthold Tenancy (with a minimum term of 6 months) with a more secure form of tenancy.

They would be entitled to up to a 35% discount, capped at £103k in London, as per the social housing discounts.

The cost of this discount should be borne by the landlord, in most cases absorbed out of the unearned capital gain they have made as property prices have risen in London. This gain has come from public and community investment in London's economy.

Savills estimated that private landlords saw the value of their property rise by 64% in the five years to 2016[10], far more than our proposed discount of 35%.

The price the renters buy at should not be less than the original price the landlord paid plus expenditure on subsequent improvements and inflation (CPI), so that no landlord can make a loss. So the discount may be less than 35% in some cases, and may even be 0%.

Landlords with between one and three properties should also be entitled to financial advice including an assessment of their options to achieve income or capital growth in more socially productive investments.

The Right to Buy could be limited to homes that are at least 25 years old, to avoid deterring investment in new build properties. Landlords could also be compensated with concessions on their Capital Gains Tax liability.

One further option would be to place a covenant on the freehold or leasehold to fix the discounted market value offered to the first buyer, so that it is passed on the future buyers.

For example, if the first buyer gains a 35% discount, they will be required to sell it at the same discount against the then-current market value, passing the discount onto the next and all future buyers. This model has been employed by Community Land Trusts to maintain affordability.

Practicalities in London

The median mix-adjusted price of a previously owned home in London in March 2016 was £555,000. The lower quartile price for the market as a whole (including new homes) was £320,000[11].

A discount of 35% on both prices would exceed the proposed cap of £103k, so that would be the maximum discount in either case. The following table sets out the required incomes for each assuming the purchaser borrows up to 4 times their net income, using the discount as a deposit:

	Median	Lower quartile
House price	£555,000	£320,000
Discount	£103,000	£103,000
RTB price	£452,000	£217,000
Required income	£113,000	£54,000

From this we can see that only very high income households renting privately would be able to exercise their Right to Buy on a median existing home, but as many as 20% of private renting households would have sufficiently high incomes to buy a lower quartile priced home. The varying prices around London mean that the policy would be much more accessible for renters in outer London on the whole, and in lower value boroughs like Barking and Dagenham, Sutton and Havering in particular.

We anticipate that, given their financial means and the level of dissatisfaction with the tenure, as many as 10% of private renters would exercise this Right to Buy in the due course of time.

It would also most likely reduce the appetite for landlords to buy existing properties, reducing demand and competition for first-time buyers, so potentially reducing price inflation.

Issues to consider

We would note two issues with this proposed policy.

The first is that, as noted, it would only benefit the richest fifth of private renters due to the extremely high prices of properties in the market.

The second is that it could be seen to reinforce the perception that home ownership is a superior tenure to renting. That perception in the UK may be related to the weak protections and rights available to private renters compared to countries where renting is more mainstream and desirable.

A Right to Co-op for Private Renters

We expect that a significant number of private renters would have the desire, and the financial means, to exercise a Right to Buy. But many more would not be able to, or would not want to take on the burdens and lack of flexibility that come with home ownership.

We propose another option for renters in shared homes: a Right to Co-op, a legal right to set up a housing co-operative to exercise their right to buy and take over their shared home (HMO).

By forming a co-operative and seeking a mortgage from an ethical lender, the renters could reduce their personal financial risk. Any discount on the market price could act, in effect, as equity against which they could borrow, like a deposit when buying a house, and which could in turn make lower rents viable. So renters wouldn't need to have saved huge deposits to exercise this right.

They would have the option of contracting with an existing housing co-operative to manage their home.

Exercising this right would give renters more control over the management of their home and the choice to change managing agents, giving them similar choice available to leaseholders with the Right to Manage.

Renters that chose the co-op option would still be protected by the same tenancy provisions, including secure tenancies and rent controls.

To be financially viable, initial rents may not be dissimilar to market rents as the co-op will need to cover its borrowing costs (though the discount on the purchase price may afford a reduced rent). We have conducted a basic financial appraisal for a co-op buying the lower quartile £320,000 home with the full £103,000 discount, having secured a low interest loan at 2% from either the GLA or a GLA-guaranteed loan from an ethical lender, and collecting £1,000 pcm in rent from the occupants (lower by £170 pcm than the lower quartile rent in London). Allowing for inflation, capital repayment, management and maintenance costs the co-op would scrape through the first 5 years and then over 25 years develop a surplus of approximately £85,000.

This ability to generate medium and long-term surpluses suggests the original discount of 35%, or up to £103,000, could be in the form of a loan that is recycled as the co-op begins to generate a surplus on its underlying borrowing.

Alternatively, over time the co-op could hold down and even cut the rents, rather than seek profit. It could also use any surpluses on borrowing, management and maintenance costs to improve the property, for example by investing in energy efficiency measures.

Rather than wait for councils to cajole and enforce the landlord, the GLA could support renters to do this for themselves.

We envisage 5,000 homes being taken into co-operative ownership and management in the first year of this policy operating, rising to 25,000 a year after five years, as the sector gains the skills and capacity to support this option.

Supporting co-ops today

Our proposals for a Right to Buy and a Right to Co-op for private renters would require primary legislation, which the Mayor could call for.

But he needn't wait.

There is nothing stopping private renters from setting up a new housing co-operative and buying an existing property.

A group of renters in Oxford recently did just this, setting up a new co-operative called Kindling and buying a 6 bedroom house for £550,000. They raised the money from Triodos, an ethical bank, and a loan stock offer to their community. They now each pay just £440 per month in rent.

They are not the only group to have done this. But in London the cost of property and the challenge involved in establishing a new co-operative have meant that recent examples are few and far between.

The Mayor could step in, visibly and vocally supporting renters to establish new co-operatives.

He could take the following steps:

- Promote the Community-Led Housing Hub to renters for support in setting up a co-operative and buying a suitable home, including advertising on the TfL network.

- Provide 5-year loans to help co-ops buy properties. After those 5 years the co-op would have gained sufficient equity in the property, and have a financial track record, to be able to secure better deals from ethical and other lenders.

- Work with existing housing co-operatives in London to leverage their considerable asset base (worth hundreds of millions of pounds) and their cash holdings to support new co-operatives.

- Provide loan and grant funding through his Innovation Fund and the Community Housing Fund for property improvements and extensions.

For renters intimidated by the responsibilities, there are options including secondary co-operatives which could provide management and maintenance services, even for individual properties.

Local communities could also choose to establish Community Land Trusts (CLTs) to buy up existing properties and manage them for the benefit of their local area, meeting particular needs such as stable homes for families with children, and tackling problems such as rogue landlords and poor energy efficiency.

We anticipate this option would see a much slower growth of Community Led Housing than with a legal Right to Co-op, but it could nonetheless grow into a mainstream option that could in turn increase the supply of new housing as co-operatives and CLTs go from existing properties to building new properties.

1 Civitas (June 2016), *Restoring a Nation of Homeownership*, http://www.civitas.org.uk/content/files/Restoring-a-Nation-of-Home-Owners.pdf

2 GLA (February 2017), *Housing in London 2017*, https://files.datapress.com/london/dataset/housing-london/2017-01-26T18:50:00/Housing-in-London-2017-report.pdf

3 Shelter (March 2014), *Can't complain: why poor conditions prevail in private rented homes*, https://england.shelter.org.uk/__data/assets/pdf_file/0006/892482/6430_04_9_Million_Renters_Policy_Report_Proof_10_opt.pdf

4 London Borough of Islington (2014), *HMO Street Survey*, https://www.islington.gov.uk//~/media/sharepoint-lists/public-records/housing/publicity/publicconsultation/20142015/20141023hmostreetsurveyreport

5 Op cit GLA (February 2017)

6 Resolution Foundation (18 June 2017), *Britain's increasingly unevenly shared property wealth is driving up inequality after a decade-long fall*, http://www.resolutionfoundation.org/media/press-releases/britains-increasingly-unevenly-shared-property-wealth-is-driving-up-inequality-after-a-decade-long-fall/

7 Op cit GLA (February 2017)

8 Eleni Karagiannaki (August 2012), *The Effect of Parental Wealth on Children's Outcomes in Early Adulthood*, CASEpaper 164, Centre for Analysis of Social Exclusion (London School of Economics)

9 Op cit Civitas (June 2016)

10 Savills (18 January 2017), *UK homes worth a record £6.8 trillion as private housing wealth exceeds £5 trillion*, http://www.savills.co.uk/_news/article/72418/213407-0/1/2017/uk-homes-worth-a-record-%C2%A36.8-trillion-as-private-housing-wealth-exceeds-%C2%A35-trillion

11 Data from the London Datastore