



# Get Britain Building **ViewPoint**



## KILLING TWO BIRDS WITH ONE STONE

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### OVERVIEW

- In the current financially constrained environment, potential first-time buyers are finding it difficult to access mortgage finance. In particular, the bank's requirement for a large deposit (low loan to value) is inhibiting potential first-time buyers.
- It is a parallel problem for developers as debt funding for development remains scarce, and where available is expensive. In addition, without first-time buyer and investor sales, developers are unable to provide security to the bank in the form of off plan sales. Without a secure exit strategy banks are unwilling to lend.
- The challenge is to come up with a dual purpose mechanism that will provide both a secure exit strategy for developers (and the banks) and also help first-time buyers take their first steps onto the housing ladder.

### INTRODUCTION

Before the credit crunch, housebuilders and developers relied on off-plan sales to secure development finance; not dissimilar to a pre-let in office development. This method of pre-selling became a noticeable feature of development finance, where a hurdle rate of 30% pre-sales was generally required by the bank before it would release construction finance. However, in light of continued market uncertainty and limited debt finance, this method is largely academic. In particular, banks remain reluctant to lend to first-time buyers and investors, reducing the demand for off-plan sales.

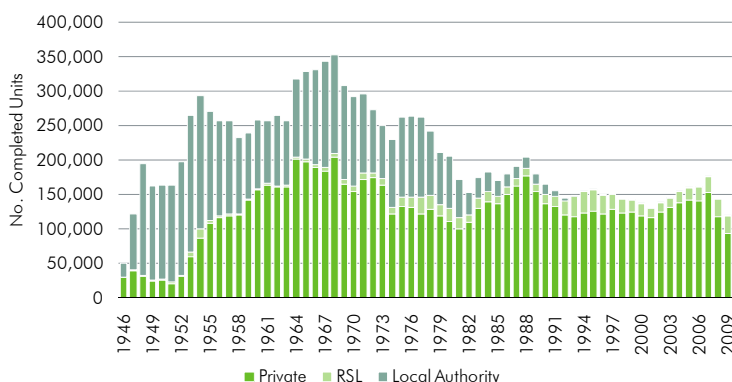
It is widely recognised that this old development model is broken and we need to consider innovative methods to engender development. And as they say, necessity is the mother of all invention...

### RENT TO BUY

Because of the subdued sales environment, the transfer of new-build stock to the private rental sector (PRS) becomes a more viable and obvious exit strategy for the developer. And the model we are presenting here indeed uses private rental as a facilitator. However, we wanted a solution (mechanism) that would also help first-time buyers; this way we can unlock both ends of the development blockage. To this end PRS is used as an intermediate stage rather than a final product.

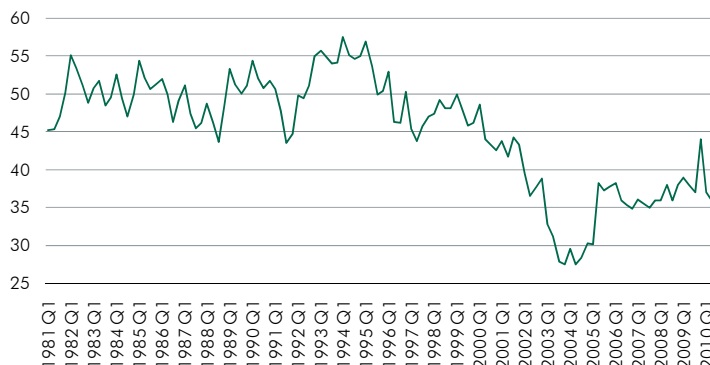
Quite simply with a rent to buy product a prospective buyer moves into the property as a private rental tenant, with an option to buy at a pre-agreed price in a set period of time. During that time, rent is paid and this is "saved" up and offset against the deposit at the time of purchase.

**Chart 1: Completions (England)**



Source: DCLG

**Chart 2: Proportion of FTB mortgages in mortgage market**



Source: CML

**THE DEVIL IS IN THE DETAIL**

The model can be adjusted to suit the individual circumstances of developer or buyer. And its flexibility is part of the appeal. For example, consider a two-bed flat, in one of the outer London boroughs, with a market value of around £350,000. A tenant pays the market rent of £1,400 with a lease option to buy in two years. If at that time all the rent is paid back, the tenant has around 10% (£33,600) towards the deposit. Alternatively after one year a 5% deposit is cumulated. To reduce risk, developers should consider an upfront deposit of 1% or 2% - this again would go towards the deposit, but would be non-refundable if the sale fell through.

**MUTUALLY BENEFICIAL SCHEME**

The benefits to the buyer are clear; the scheme essentially acts as a savings plan and helps the buyer save up a deposit and facilitates his ability to purchase. The buyer also gets to "try before you buy"; buying your first property in an uncertain world can be daunting. Of course there are risks, for example, the terms and conditions of any mortgage offer would almost certainly change over the rental period, which may affect the buyer's ability to transact.

For the developer this product provides security and an exit strategy to satisfy the bank; the monthly rent can effectively be used to service the debt until the sale completes. It also provides the developer with a number of strategic options. For example, on completion the developer could either retain his interest in the development or to package up the lease into an SPV and sell on to an investor. Depending on the long-term strategy the developer could choose different lease lengths.

**We are not suggesting that rent-to-buy in the panacea for all that ails the development market. However, it is one of a number of innovative solutions we are investigating. The big plus of rent-to-buy is its ability to unblock both ends of the development chain; it provides a funding mechanism for both first-time buyers and also developers.**

**FIRST TIME BUYER FACTS AND FIGURES**

Average age of a first time buyer is now 38.

Average price of a first-time buyer property is £142,457; 16% lower than average overall house prices.

There were less than 200,000 first-time buyers in both 2008 and 2009, less than half the longer-run average.

According to the CML, first-time buyers made up just 35% of house purchase loans in May, the lowest proportion since August 2007. In contrast, throughout the 1980s and 1990s first time buyers made up around half the market.

This confirms getting a mortgage remains difficult for those first-time buyers that do not have a substantial deposit.

The biggest challenge is who bears the house price risk. If the sale price is pre-agreed the buyer bears the risk of falling prices, but could gain in a rising market. If prices are pre-agreed the buyer must be comfortable with any projected increase in price. If prices reflect market value at point of sale, the seller bears the risk of falling prices, but gains in a rising market.

But, there are trade offs; a longer lease may enable a larger deposit to be saved, but the buyer must make sure the home has extended appeal. A one bed flat might have a shorter shelf life than a larger two bed apartment.

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