Locked Out

How property crowdfunding could help the next generation of homeowners

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February 2016

SMF Social Market Foundation

Supported by

Property Partner

FIRST PUBLISHED BY

11 Tufton Street
London SW1P 3QB

February 2016

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ABOUT THE SOCIAL MARKET FOUNDATION

The Social Market Foundation (SMF) is a leading cross-party think tank, developing innovative ideas across a range of economic and social policy. The SMF's current research themes are: Productivity and Growth; Reforming Financial Services; Cost of Living; and, Public Service Reform. The SMF champions policy ideas which marry markets with social justice and take a pro-market rather than free-market approach. Its work is characterised by the belief that governments have an important role to play in correcting market failures and that a sustainable market economy rests on social and political foundations that are widely regarded as fair. www.smf.co.uk

ABOUT PROPERTY PARTNER

Property Partner (www.propertypartner.co) launched in January 2015 and already has nearly 6,000 investors, who have crowdfunded £23 million of residential property. The company uniquely combines residential property crowdfunding with a secondary exchange upon which investors can trade their holdings.

Property Partner allows anyone to invest in an individual property of their choice, with as little or as much they wish, so they can own a share, receive rental income, and capital gains if property prices rise. The letting and management of the properties is carried out on behalf of investors.

ACKNOWLEDGEMENTS

The Social Market Foundation (SMF) is grateful to Property Partner for their generous sponsorship of this research project. The authors also wish to thank other industry members and bodies who helped through the research process, including Crowdsurfer, The House Crowd and LendInvest. Thanks also go to colleagues at the SMF who contributed to the ideas and research in this report. Any errors remain those of the authors.

EXECUTIVE SUMMARY

The UK's housing market exhibits many symptoms of failure. This report shows that:

- Homeownership rates among young people have declined dramatically in the UK in past decades despite nine out of ten of this group aspiring to buy a home.
- Young people now face high barriers to entry because of high house prices and strict lending criteria, as well as low yields on savings that make it hard to build a deposit.
- If homeownership rates among 25 to 34-year-olds in 2016 were the same as in 2001, we calculate that an additional 1.8 million young people in this age bracket would be homeowners in England.
- There has been major expansion of young people in the private rental sector. Between 2003/04 and 2013/14, the proportion of private-rented households among the 25-34 year old age bracket more than doubled from 21.4% to 48.2%. However, there are persistent concerns about quality, with almost a third of the stock not meeting the Government's quality benchmark.
- Housing supply has fallen significantly short of demand for successive decades. Over the last five years alone demand for 645,000 additional homes has gone unmet, driving up prices.

The report looks in depth at one particular market-based solution to these problems: property crowdfunding. Property crowdfunding allows would-be investors to club together, through online platforms, to buy a share of a property. Although property crowdfunding is in its early stages in the UK, the dramatic growth of alternative finance in the UK and the huge expansion of real estate crowdfunding in the USA – which has hit $1bn – suggest that it may grow significantly in the years ahead.

In this report we consider how the housing market may evolve over the decade ahead and the challenges and opportunities this may present.

Our future scenarios reveal important potential roles for property crowdfunding to help address the problems in the housing market, including:

1) **Making saving for a deposit easier for aspiring homeowners** in an environment where house prices continue to increase. Those saving for a deposit to buy a home would have a way to earn returns that keep up with house price growth.

2) **Widening participation in property ownership** by reducing the barriers to entry and allowing a greater number of people to share in property price growth.

3) **Improving quality in the private rental sector** by applying greater commercial discipline to property management along with benefits from economies of scale.

4) **Boosting new supply** by providing equity funding to SME housebuilders who otherwise would not be able to pursue specific development projects.

The report concludes with an analysis of what the Government should do to enable the market to develop and to ensure that individuals and society can benefit from its features, whilst ensuring that consumers are properly protected. The report argues that:

- Property crowdfunding should be made eligible for inclusion in the new Innovative Finance ISA. The current exclusion of property crowdfunding is based on a misrepresentation of the features of the product as a high-risk equity product, and inclusion within the familiar and trusted ISA wrapper would help encourage consumers to explore the potential of property crowdfunding.

- The Government could also consider allowing savers to use property crowdfunding when saving in a 'Help to Buy ISA', so would-be first-time buyers can build a deposit in a product that tracks house prices.

- The Government should introduce a new tax-favoured investment product to incentivise investments in new housing supply. The 'Help to Build' product would offer an incentive for people to invest in property crowdfunding products that provide equity capital to SME developers when they build homes to rent. This could boost housing supply.

- The Government should consider what role property crowdfunding could have within broader shared ownership policy. There may be benefits to looking at property crowdfunding models to give social tenants the option of buying smaller stakes in their home and enabling people to build up (and reduce) their equity stake more flexibly. There may be wider implications for shared ownership policies as property crowdfunding develops in the UK with more private tenants gaining the opportunity to buy an equity stake in the home they live in.

CHAPTER 1: THE UK HOUSING CRISIS

This chapter describes how young people, despite their aspirations to own a home, are increasingly locked out of property ownership. It explains the high barriers to entry, the challenges that young people face building a deposit for their first home and the importance of addressing fundamental failures in the housing market – such as the shortage of supply. It suggests that new finance mechanisms such as property crowdfunding could potentially be used as a way of helping to address these challenges, thus assisting the Government in meeting its ambitions on a million new homes built and a million more homeowners by 2020.[1]

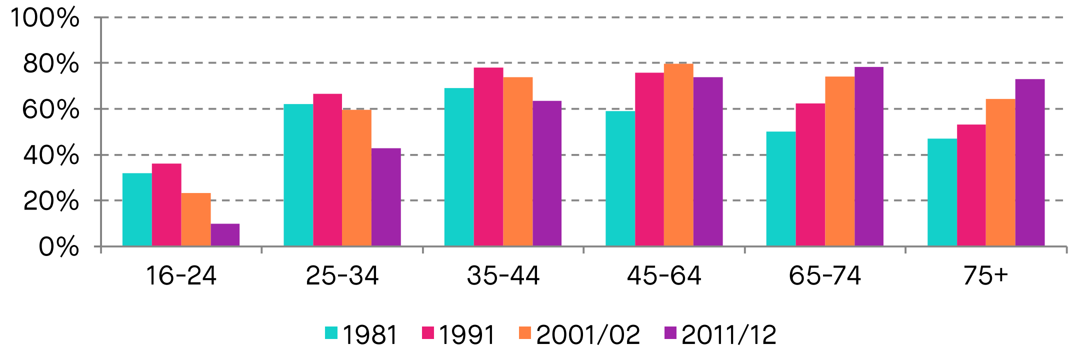
1. Young people locked out of property ownership

Young people unable to fulfil their aspirations of homeownership

Property ownership is an aspiration that is widespread in the UK: 84% of the whole population would prefer to buy their home than to rent.[2] This desire to own a home is particularly pronounced amongst younger age groups: 87% of 25-34 year-olds would prefer to buy and 89% of 35-44 year-olds hold the same view. More detailed survey evidence shows that this predisposition towards property ownership stems from a desire for security, for making the home one's own, for lower costs and because housing is viewed as a 'good investment'.[3]

However, as it stands currently, many younger people who would previously have been homeowners have been unable to get on the property ladder. While the twentieth century witnessed huge increases in homeownership levels, property-ownership has declined this century from 71% in 2003 to 63% in 2013.[4] This shift away from homeownership has been felt markedly among the younger population. As Figure 1 illustrates, for 25-34 year olds ownership rates fell from 67% in 1991 to 43% in 20011/12; for 35-44 year olds from 78% to 64% over the same period. In fact, recent data shows that this trend has continued in the last five years, with a significant fall in homeownership rates in the under-35 age group, including among young professionals.[5] If homeownership rates among 25 to 34 year olds in 2016 were the same as in 2001, we calculate that an additional 1.8 million people would now be homeowners in England.[6]

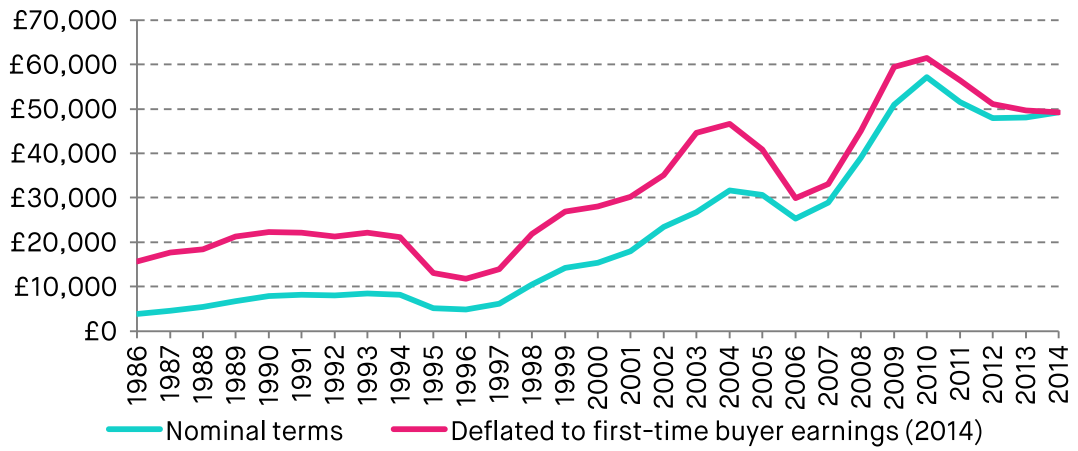
Figure 1: Proportion of people who were homeowners by age group from 1981



Source: English Housing Survey (EHS) 2012 to 2013[7]

A number of factors are conspiring to make it harder for people to get on the property ladder. First, house price growth has made property ownership less affordable. Prices as a ratio of earnings have increased from four-times average (median) gross earnings in 1993 to seven-times average earnings in 2013.[8] This has combined with stricter lending rules following the financial crash. The size of deposit needed to purchase a property as a first-time buyer has risen from around 15% at the turn of the millennium to over 20% today.[9] Therefore, barriers to entry in property ownership are now very high. Figure 2 below shows that, even in real terms, the average deposit has tripled from £16,000 in 1986 to £49,000 in 2014.

Figure 2: Average first-time buyer deposit by year



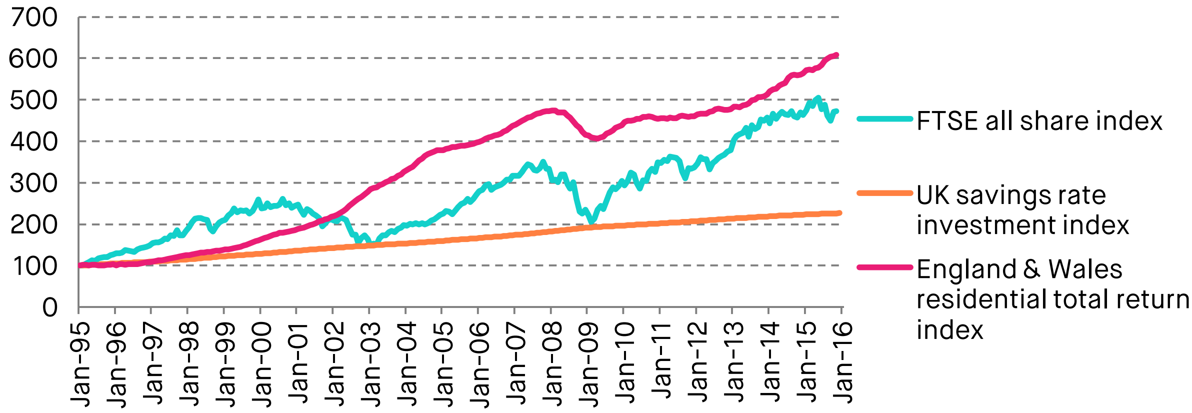
Source: SMF calculations based on ONS House Price Index[10]

A second factor constraining would-be buyers is low interest rates on their savings. While low interest rates benefit individuals in their ability to borrow at affordable rates, the flipside is that would-be first-time buyers struggle to find investments that can track house prices as they build a deposit for their first home.

As

Figure 3 shows, house price appreciation has outpaced the interest that people can earn in a traditional savings account. The result is that, for many, the savings set aside lose value compared to house prices over the time it takes to build up the necessary deposit. Even with the 2008-09 crash, house price appreciation has easily outperformed cash savings. £100 invested in property in 1995 would by 2015 be worth over £600, while the same initial sum in cash would have grown to only £226 in an instant access savings account. Even an investment in the FTSE could not have kept up with the returns on housing over the past two decades.

Figure 3: Returns to investment in housing, shares or cash (£ hundreds)



Source: FTSE all share index; Land Registry; ONS; Bank of England[11]

The consequences of being locked out

The consequences of the problems described above are significant. The inability of younger generations to access property ownership is contributing to high levels of intergenerational asset inequality. Today's under 40s will be less well off than their parents in part at least because they are unable to benefit from housing asset appreciation in the same way that their parents did.[12] An exacerbating factor is that this shift away from homeownership means many are in the private rental sector and not by choice. Between 2003/04 and 2013/14, the proportion of private-rented households among the 25-34 age bracket more than doubled from 21.4% to 48.2%.[13] A mixed market of owner-occupied, private rent and social rent housing is necessary to meet people's different preferences. A well-functioning private rental sector gives people flexibility and therefore facilitates labour market mobility.

Despite these benefits associated with rented accommodation, many tenants have faced increases in rent.[14] There have also been persistent concerns about the quality of the housing stock: nearly a third (29%) of private rental sector homes fail to meet the Decent Homes standard.[15] There is a need therefore to boost the quality of housing within the private rental sector, including increasing the professionalisation of the sector. Recent policy reforms introduced by the Government have altered significantly the tax treatment of buy-to-let investment, with potentially major consequences for investors and the private rental sector.[16] In the July 2015 Budget, the Chancellor announced that the Government will restrict relief for finance costs on residential properties to the basic rate of Income Tax. Subsequently, in the Autumn Statement, the Government introduced a Stamp Duty surcharge of 3% on buy-to-let properties and second homes.[17]

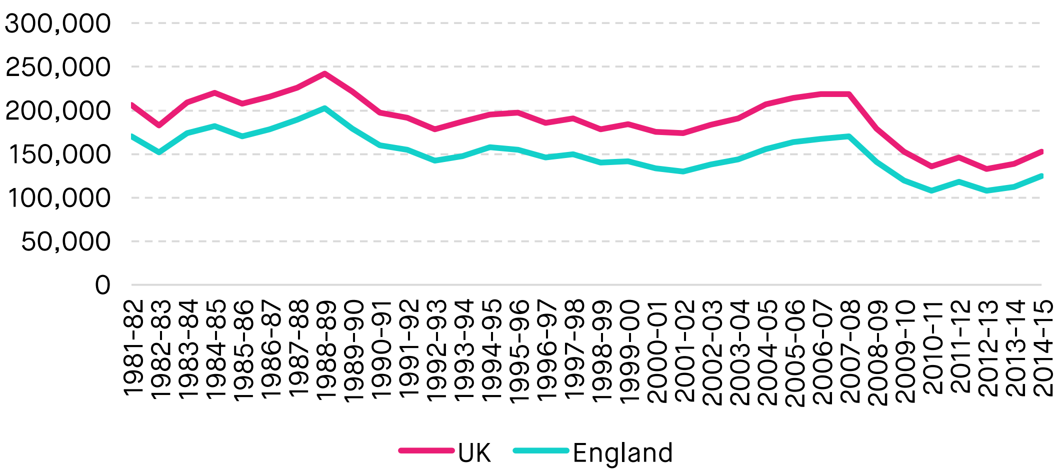
This section has shown that:

- **Young people are increasingly locked out of homeownership.**
- **Younger people face high barriers to entry caused by high house prices and stricter lending criteria.**
- **Aspiring homeowners face difficulties saving for a deposit in a way that can keep track with house price variation in a low-interest environment.**

2. Addressing the root problem in the housing market: supply

Addressing the root of these problems is complex and difficult. A fundamental cause of the affordability problem – and consequently the locking out of younger generations – is a long-standing failure to build sufficient homes to match the growth in demand for new households.[18] Population growth means that we need to build an estimated 240,000 new homes each year just in England.[19] In the financial year 2014/15, we were over 100,000 homes short of this target.[20] Looking further back, the average number of housing completions per year across the UK in the last ten years is 168,890.[21] We calculate that population growth and demographic factors, alongside constrained supply, means that over the last five years alone demand for 645,000 additional homes has gone unmet, driving up prices.[22] It should be noted, however, that this picture of unmet demand varies significantly by region – for instance London faces particular challenges in matching the demand for additional homes with new supply.[23]

Figure 4: New homes completed each year from 1981: England and the UK



Source: Department for Communities and Local Government[24]

Barriers to achieving this desired expansion of supply are multiple. Local communities often object to new housing especially in high-demand areas such as London and the South East.[25]

Evidence also suggests that the market would benefit from greater competition and diversity among housing developers. Twenty years ago, the SME sector provided 40% of homes; in 2013 this had fallen to 25%. This was in part at least a consequence of the financial crisis and recession, although SME development has not recovered with the broader economy. Some 50% of all new homes are now built by the eight largest developers.[26] A more diverse and competitive supply-base would make the market more responsive to demand and help boost new builds.[27] Smaller companies may have different specialisms (for instance in brownfield development) and may be ready to take on small sites that do not suit larger developers. This has been recognised recently by a Government initiative to commission new supply direct from SME developers, and the £100 million Housing Growth Partnership announced in 2015.[28]

While a range of barriers restrict the supply of new homes by smaller providers, a crucial obstacle is access to finance. Despite modest improvements in recent years, a 2015 survey by the Federation of Master Builders found that 'lack of finance to the company' was still the second most frequently cited constraint on their ability to build more houses (behind lack of available and viable land).[29] Mechanisms are needed that can channel additional capital as finance to SME developers.

This section has shown that:

- **Boosting supply must be a fundamental part of any attempt to address the failures in the housing market.**
- **Directing additional finance at SME housing developers could improve the competitiveness of the market and boost supply.**

3. The focus of this analysis

Addressing these huge challenges will involve significant action across a range of policy fields. The Government is already intervening in areas such as planning and social housing.[30] This report looks at one particular market-based solution that could help tackle the problems that has received little attention: namely property crowdfunding, an alternative finance mechanism. In responding to the problems identified above, it may offer a route:

1. To **widening participation in property ownership** by lowering the currently very high barriers to entry.
2. To provide individuals with an **alternative investment vehicle that tracks house prices** as they build up a deposit for a first home.
3. To **direct fragmented sources of potential investment into productive use as sources of finance for new housing development thus boosting supply.**
4. To **drive up standards in the private rental sector** through greater professionalisation of management and greater commercial discipline.

The remainder of the report is structured as follows:

- Part II describes how property crowdfunding works and the evolution of the market.
- Part III scans ahead to how the UK housing market may develop over the next ten years and the potential benefits that may come from property crowdfunding.
- Part IV discusses the policy implications of our analysis.

CHAPTER 2: THE EVOLUTION OF THE UK PROPERTY CROWDFUNDING MARKET

This section describes the evolution of the property crowdfunding market and other forms of alternative finance in the UK and beyond.

What is property crowdfunding and how does it work?

Crowdfunding is a mechanism by which people and businesses raise money from the public, to support a business, project or individual. Online platforms link those seeking capital to individuals who are ready to invest.[31] Equity property crowdfunding allows the general public to buy small equity stakes in residential property. As such, it is distinct from platforms that facilitate lending to individuals or businesses secured on property. Investors buy shares in a Special Purpose Vehicle set up to purchase a property. The risks investors face relate to the value and income derived from that specific property rather than the performance of the crowdfunding platform more generally. Investors can buy a stake in more than one property.

The investor typically receives a portion of the property's rental income, minus property management charges and any costs associated with the upkeep of the property. Investments are generally for a fixed period, and the investor may also benefit from asset appreciation when the property is sold at the end of the investment period.

Characteristics of the UK property crowdfunding market currently

There are currently three main companies offering products, with investors able to buy equity stakes ranging from a minimum of £10 to £500.[32] These are the House Crowd, Property Moose and Property Partner. There are also a number of smaller crowdfunding companies offering equity in UK property. These include Crowd2Let, PropertyCrowd, Mayfair & Morgan, and CrowdLords. In addition, there are a number of other companies offering debt rather than equity products related to property. These include LendInvest and Landbay, which offers customers the opportunity to invest in property loans – although not to own the property itself. Property crowdfunding companies are obliged to comply with FCA regulations.[33]

Once invested, the products offer different means of exit. In some cases, properties are automatically sold after a given period of time, in some cases investors vote after a given period of time on whether to sell the property. Some products have a secondary market, allowing the initial investor to sell their equity stake on to a third party.

As it stands, the most recent publicly-available data suggests that the total amount of investments across the three main providers is £40 million.[34]

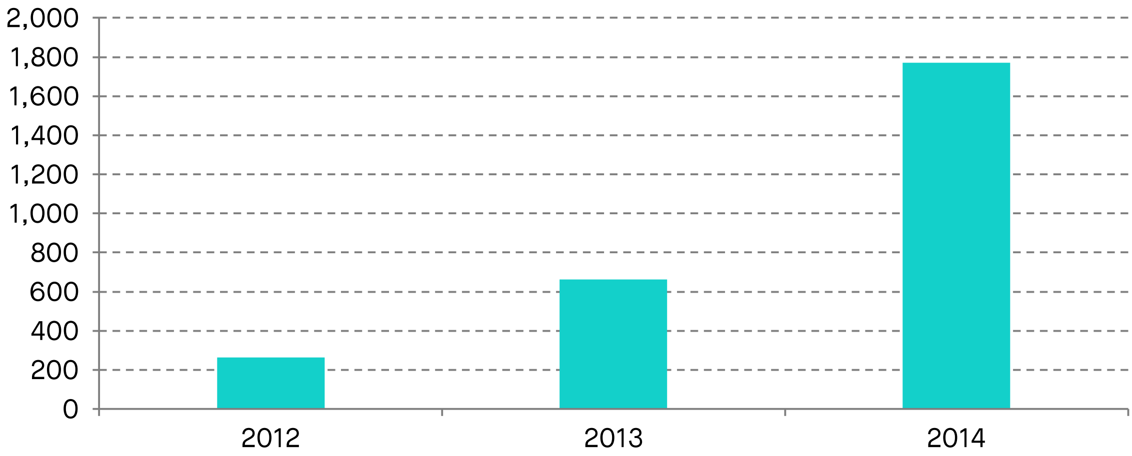
Potential for growth in the future – crowdfunding in the UK and beyond

Although the UK property crowdfunding market is relatively new, other crowdfunding markets are more established and give an insight into the significant potential for growth in the sector.

Growth of the market in the UK

Figure 5 shows the size of the overall alternative finance market in the UK. Peer-to-peer lending was founded in the UK in 2005. In 2014, £1.2 billion was lent to businesses and consumers through peer-to-peer platforms, a 168% increase from 2013.[35] The growth of peer-to-peer lending in the UK has been helped by the support of the British Business Bank, which has directed funds through several peer-to-peer platforms.

Figure 5: Size of UK alternative finance (£ million)



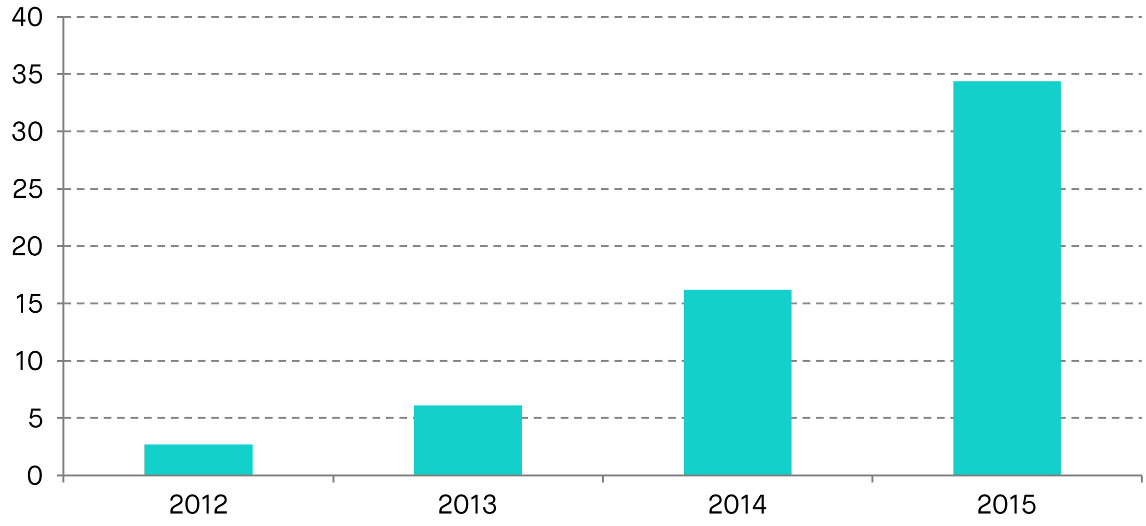
Source: University of Cambridge Centre for Alternative Finance; prices converted from EUR to GBP at January 2016 exchange rate.

Lending to businesses is the largest form of peer-to-peer lending, with nearly £1bn lent to businesses alone in 2014. However, equity-based crowdfunding, the model used for property crowdfunding, has also seen dramatic growth of 420% a year (between 2012 and 2014).[36] In total, the alternative finance market – encompassing peer-to-peer lending, equity-based crowdfunding, and debt-based securities – rose to more than £1.7 billion in 2014, and has continued to grow since then.

Growth of the market internationally

Crowdfunding is a global phenomenon. In 2015 the global volume of crowdfunded investing was worth an estimated $34bn[37] having more than doubled in each of the proceeding three years, as illustrated in Figure 6 below.

Figure 6: Growth of the global crowdfunding market ($ billion / year)



Source: Forbes.com / Massolution 2015 Crowdfunding Industry Report

In 2013 the World Bank estimated the market could be as large as $90-96bn by 2025,[38] though if current growth continues it is likely to reach this level as early as 2017.

In global terms, property crowdfunding was the fourth largest crowdfunding sector by volume in 2014, as shown in Table 1. More recent market predictions forecast that the size of the global property crowdfunding market would grow by 150% in 2015 and reach £2.5bn.[39] Latest reports estimate that the property crowdfunding market in the USA has hit a funding volume of $1bn USD.[40]

Table 1: Funding volume of top 5 categories of crowdfunding globally ($bn, 2014)

Type of crowdfunding	Total (billion USD)
Business and entrepreneurship	6.7
Social causes	3.06
Films & performing arts	1.97
Real estate	1.01
Music & recording arts	0.74

Source: Crowdsourcing.org / Massolution[41]

This section has shown that:

- **The property crowdfunding market already has significant diversity of provision and offers a range of differentiated products to consumers.**
- **The growth of UK crowdfunding more generally as well as experiences in the USA suggest that the market could expand appreciably in the years ahead.**

CHAPTER 3: LOOKING AHEAD TO 2026

In this section, we use scenario analysis to look ahead to 2026 to understand how the UK housing market may evolve, and the potential role of property crowdfunding. The purpose of this analysis is not to predict the housing market context in 2026 but to set out a 'core scenario' and then describe how the outcomes could vary if significant factors affecting the shape of the housing market change over the next decade (see Endnote for further explanation).[42]

'Core scenario' in 2026

Housing supply increases, but not quickly enough to keep up with demand; prices continue to rise but more slowly; housing inequality grows and policy prioritises owner-occupation; pressure grows on the private rental sector resulting in political attention.

Housing supply fails to meet targets

Ten years ahead we foresee a situation within which government efforts have increased housing supply, but not to the level needed. The government gets close but does not achieve its ambition to build one million new homes by 2020,[43] just as past governments struggled to meet their targets.[44] Building continues at the rate seen in 2015, with around 195,000 homes built a year.[45]

Housing demand continues to grow

Meanwhile, we foresee relatively strong population growth driven by a combination of migration into the UK, longer lives and a relatively high birth rate compared to recent decades. Between 2016 and 2026, the population increases by 6.4%, equivalent to 4.2 million additional people.[46] In parallel, the average household size continues to shrink,[47] meaning the number of homes needed grows at a much faster pace than the population growth alone. The number of households in the UK will rise by 9% over the decade to 2026, meaning more than 2.5 million additional housing units are needed.[48] The consequence is that the shortfall of 645,000 in 2016 has grown by a further 650,000 homes by 2026.

Housing affordability falls further

With supply failing to make up the shortfall and keep up with rising demand, house prices have continued to rise albeit less quickly than they did in the years leading to 2016.

Interest rates remain relatively low. Together with gradually rising earnings and moderate inflation,[49] this means that mortgages remain relatively affordable. But supply constraints and strict lending conditions result in house prices continuing to rise significantly and outstripping earnings growth.[50]

These changes in the housing market to 2026, along with the prevailing economic conditions, make it ever-harder for young people and other non-homeowners to afford their own home. Yields on cash deposits remain far behind house price growth making it very difficult to save for a deposit. Single people and couples with children are increasingly being frozen out of homeownership. Meanwhile, rising property prices will make those who have already bought housing better off in wealth terms, contributing to rising inequality. Nationally, home ownership levels continue to fall among younger generations.

Government policy stimulates further housing demand and pushes prices even higher

In response to declining levels of home ownership, the government focuses, as it has over a number of decades, on demand-side attempts to boost owner-occupation. Helping younger generations onto the property ladder where they are locked out becomes an even greater policy priority. In part, this is because older generations (a core voter group), who have previously benefitted as the value of their homes has grown, observe their children unable to purchase a home of their own and demand government action to help. Demand-side measures continue to be popular among the electorate to boost housing affordability.[51]

The Help-to-Buy scheme is extended, with an increase on the upper limit of the equity loan across the country, following the increase available to first-time buyers in London from 2016.[52] The mortgage guarantee scheme, originally intended to run until December 2016, is extended for an additional two years.[53] Help to Buy ISAs support those saving for a deposit.

But, in the face of limited expansion of supply, these measures drive further price increases.[54]

Rents increase too as a result of housing shortages

This tenure policy persists also within social housing. Social housing policy increasingly becomes affordable homeownership. Affordable homes are now built predominantly for sale rather than to rent.[55] The availability of social rental stock also declines following the extension of the Right to Buy to housing association tenants.[56] Slow replacement of housing association and local authority stock, and replacement with homes on part-buy, part-rent models, mean more people rely on the private rental sector.[57] But, while focusing on boosting owner-occupation, the government further squeezes buy-to-let investors.[58]

The cumulative impact of these policies means rents increase as well as house prices, making housing increasingly unaffordable for a growing proportion of the population. Although the government manages to increase homeownership levels among middle-class young professionals, ownership rates continue to decline across the population as a whole. With social housing increasingly rare, more and more people are pushed into the private sector. Poor quality accommodation becomes an even bigger issue as local authorities (who are responsible for implementing standards on private rental stock) continue to face severe funding constraints.

In the last phase of the period, the government also comes under significant political and economic pressure to improve the quality of private rental accommodation, to improve living standards and to reduce housing costs across the population as a whole. The policy priority shifts towards encouraging investment in new housing supply, with a greater focus on rental stock particularly from institutional investors and other large housing providers, to help improve the quality of accommodation.

Policy implications and the role of property crowdfunding

With large deposits needed to buy property with a mortgage as an owner-occupier, and returns on cash savings falling behind house price growth, property crowdfunding could play four important roles:

1) Make saving for a deposit easier

Property crowdfunding could provide those who are saving to buy a home with a way of earning returns that keep up with house price growth. Keeping savings in a cash account for years, where the interest earnt would be lower than house price growth, would leave would-be buyers seeing the purchasing power of their savings eroded by house price inflation. Property crowdfunding could play a particularly important role in widening participation in the South East and London, where supply is likely to remain tightest and price growth strongest.

2) Access to the property market

It could democratise the property market, allowing a greater number of people to share in property price growth. Rather than limiting access to those with a deposit of thousands of pounds, property crowdfunding could allow those with smaller sums to gain a stake in the asset class. This may reduce demand for owner-occupation – helping individuals to have a stake in the housing market without owning their own home, and help to reduce asset inequality by lowering barriers to property investment. This may have longer-term advantages for the political economy of housing by narrowing the difference between 'insiders' (homeowners) and 'outsiders' (non-homeowners).[59]

3) Professionalise the buy-to-let sector

Property crowdfunding may provide a way to help professionalise the buy-to-let sector. By uniting small capital stakes, greater commercial discipline is likely to be applied to the management of properties. Meanwhile, crowdfunding platforms can benefit from economies of scale in their management of properties, thus driving improvements in the quality of rental accommodation.

4) Boosting supply by providing funding to SME housebuilders

Property crowdfunding could play an important role in directing additional capital towards SME housebuilders and helping to increase supply. This could happen, for instance, if consumers were able to take an equity stake in build-to-rent developments. Property crowdfunding also provides a way for those with a growing interest in increasing housing supply, for example homeowners who see their children locked out of the market, to drive funding towards SME developers. Under this core scenario, we foresee an evolution of property crowdfunding – as products emerge that not only provide equity stakes in existing homes but also deliver equity finance into new developments. The dynamic nature of crowdfunding may also facilitate more rapid deployment of capital than is likely through institutional investment. Such products are not yet readily available in the market and so additional government action may be needed to stimulate demand.

Alternative scenarios in 2026

Over a ten-year period, the housing market may be affected by a wide range of economic, social, political and regulatory factors. The scenario described above indicates a likely course of events – but there are many factors which could alter the outlook. Here, we consider some of the principal variables – economic factors, social and demographic factors and public policy – and explore how they could change the outlook for both the housing market over the next 10 years and for the development of property crowdfunding.

ECONOMIC FACTORS The health of the economy influences both demand for housing and the ability to increase supply		
Compared to central scenario, the economy is...	**Consequences for the housing market**	**Potential role for property crowdfunding**
Healthier	• Increased demand for housing with higher confidence and rising incomes, house prices grow more strongly, interest rates rise and reduce mortgage affordability. • Higher housing inequality.	*Property crowdfunding could play an increasingly important role in democratising access to the housing market.*
Weaker	• Reduced confidence makes it even more difficult to secure funding to increase the housing supply, but demand for housing continues to still increase. • House price growth falters, but a shortage of rented accommodation means rents continue to rise. • Buy-to-let investors and owner-occupiers are vulnerable to price falls. • Regional variation in the economy drives greater variation in house price growth across different areas.	*Property crowdfunding could reduce the risk that buy-to-let investors lose out by making it easier for them to create a geographically-diverse property portfolio.* *In a traditional market where homeowners and buy-to-let landlords are highly leveraged, this fall in house prices could lead to negative equity and could amplify the systemic risks to the economy. However, because property crowdfunding uses low or no leverage, these risks would be significantly reduced.*

SOCIAL FACTORS Population growth, household formation and attitudes to housing determine housing demand & willingness to expand supply		
Compared to central scenario…	**Consequences for the housing market**	**Potential role for property crowdfunding**
Stronger housing demand	• Lack of finance flowing to builders, planning restrictions and skills shortages, stop supply increasing to meet demand. The housing shortage grows. • Pressure on the private rental sector emerges more quickly. Overcrowding and poor conditions become more common.	*Increasing and improving private rented stock will become a political priority more quickly. The government may incentivise investments in increasing housing supply.*
Weaker population growth	• Housing demand remains strong in London and the South East. • Weaker demand in regions outside the south east means that house prices diverge across the country. This may limit labour mobility and make it increasingly difficult for young people to move to seek work.	*Property crowdfunding could help those with smaller savings pots to gain exposure to property in areas where prices are still rising, helping them earn a return which keeps up with house prices in those areas.*
POLICY FACTORS Government priorities around housing supply and tenure policy		
Compared to central scenario…	**Consequences for the housing market**	**Potential role for property crowdfunding**
Successful efforts to boost housing supply	• House price growth begins to cool but prices remain relatively high compared to incomes. Saving for a deposit is still hard. • New supply is likely to be concentrated in the private rental sector and owner-occupation. Social housing stock will fall through right to buy, increasing demands on the private rental sector and creating political pressure to improve standards.	*Property crowdfunding provides an efficient way to save for a deposit.* *It also provides a vehicle to professionalise the private rental sector and improve the quality of housing for renters.*

This chapter has shown that:

- **In the central scenario, there is significant potential for property crowdfunding to democratise property ownership, making it easier to own a stake in a rising market, reducing intergenerational inequality. It could also inject commercial discipline and economies of scale into the private rental sector. Finally, property crowdfunding could play an important role in boosting supply by channelling disparate retail capital towards new supply built by SME developers.**
- **In different economic, social or political conditions the benefits from crowdfunding do not disappear, though they may be different. For instance, property crowdfunding could help people diversify their housing assets in a future in which regional economies and house prices falter.**

CHAPTER 4: POLICY OPTIONS

Chapter 3 illustrated the range of potential benefits that could derive from a well-functioning property crowd-funding market as the housing market evolves over the next decade. However, the realisation of the gains from property crowdfunding is likely to rely on an appropriate tax, regulatory and legislative environment. In this chapter, we discuss how policymakers can ensure that we make the most of this innovative new market model.

Regulation must balance the need for providers to be able to innovate and the fact that property crowdfunding is likely to appeal to relative inexperienced investors.

The rapid expansion of the crowdfunding market – including in property crowdfunding – implies that regulatory barriers are not causing huge hurdles to innovation in the market. We have already seen many providers emerge (as described in Chapter 2). Property crowdfunders are obliged to operate under regulation from the Financial Conduct Authority (FCA).

Under existing regulation, property crowdfunding firms must display clear and complete information about the investment opportunities available, in a way that is not misleading, and alongside appropriate risk warnings.[60] This, together with limits on the amount that retail investors can invest in risky activities like property crowdfunding, provides reasonable protection for most consumers.[61]

Platforms could work to improve information about diversification. Here, the more developed platforms for peer-to-peer lending provide a good example. Many of these platforms now offer an automatic diversification service, helping consumers to pick a wide range of investments and preventing consumers from taking on too much risk by putting all their cash into only a handful of investments. The investments involved in most property crowdfunding platforms are larger than many debt-based crowdfunding products, so diversification is less easy, but it should be a greater consideration in the future as the market grows and deepens.

1. Boosting the availability and take up of property crowdfunding

Innovative Finance ISA eligibility

Most other forms of savings and investments – be it cash, traditional stocks or other forms of crowdfunding – are eligible for some sort of tax break. Property crowdfunding is, at present, a notable exception. The Coalition Government and the current Conservative Government have both prioritised higher levels of household saving as a route to improved financial resilience across the population. The primary tool used to achieve this has been through the tax-free Individual Savings Account (ISA). Every adult in the UK has an annual ISA allowance, an amount that can be saved or invested in specially-wrapped products to protect returns from capital gains tax and from income tax on the point of withdrawal. The ISA label is well recognised by consumers. Roughly half the UK adult population, over 23 million adults, have an ISA.[62] ISA wrappers also help consumers to overcome their risk aversion and preference for cash, to earn higher returns and put capital to more productive use.[63]

The annual amount savers can place in these tax-free accounts has increased substantially in recent years, from £7,200 in 2009/10 to £15,240 in 2015/16.[64] As well as increasing the annual allowance, the Government also extended the flexibility on where the investments went: previously savers had a choice between saving in cash accounts or investing in stocks and shares; following the 2014 Budget, savers can now allocate their full allowance across available products however they wish. From 6 April 2016, consumers will also be able to invest in certain types of alternative finance through a new "Innovative Finance ISA". The purpose behind extending ISA eligible investments was to improve competition in the banking sector by diversifying available sources of finance,[65] and to help consumers in search of better returns in a prolonged period of low interest rates. However, the types of alternative finance products that consumers can include in the new ISA wrapper will initially be limited to debt products – for example peer-to-peer lending or crowdfunded debt.[66] Crowdfunding has been excluded.

Table 2: Product eligibility for ISAs (not including cash ISAs)

Product type	**Eligible for ISA?**		**Which ISA?**
	Equity	*Debt*	
Listed stocks and shares	✔	✔	Stocks and Shares ISA
Company crowdfunding (e.g. mini-bonds, shares in non-listed companies)	**X** (but eligible for EIS and SEIS)	✔	Innovative Finance ISA
Peer-to-peer loans	**N/A**	✔	Innovative Finance ISA
Property crowdfunding	**X**	✔	Innovative Finance ISA

As Table 2 shows, this means that while debt-based property crowdfunding (loans made to firms building homes or to individuals seeking mortgages) can be included in the Innovative Finance ISA, crowdfunded property equity is excluded. As a result, tax must still be paid on both rental income and capital appreciation of these assets. The lack of this tax-advantaged status may be expected to dampen investor appetite compared to other products that enjoy such reliefs. In turn, this may mean that there is not a level playing-field in the market as some products benefit from the status of the ISA wrapper whilst others do not.

The decision to exclude crowdfunded equity (but not crowdfunded debt) from the Innovative Finance ISA was made on the basis that the ISA label must retain its reputation as a trusted product, and that some crowdfunded equity products are higher risk than would usually be considered suitable for retail investors.[67] A high-profile failure, in which many retail investors could lose their ISA investment, could cause significant damage to the ISA brand, and could have the effect of discouraging saving and investment more generally. Given its status the Government is right to seek to protect its reputation.

However, the current classification does not fully recognise the varied risk-attributes of different crowdfunded equity products. As the Government has noted, small, new businesses offering equity through crowdfunding platforms have a high risk of failure, which would leave investors facing losses, and are unlikely to provide individuals with regular returns on their investment.[68]

Property crowdfunding does not share the same characteristics. Because housing is a basic service and because it is a rationed good, there is negligible risk that the underlying asset will lose value entirely, though clearly it may be expected to rise and fall with wider property prices. For the same reasons, its income is also much more predictable.

This logic is reinforced by the fact that 95% of the equity purchased in small or mid-sized new firms through crowdfunding platforms is eligible for tax relief either through the Enterprise Investment Scheme (EIS) or Seed Enterprise Investment Scheme (SEIS)[69].
These schemes are designed to encourage investment by “angel” or venture capital investors who are used to making risky bets in early-stage firms. Property crowdfunding is not considered sufficiently risky to benefit from these reliefs. It might, in addition, be noted that investors – such as pension funds and annuity funds – consider property a low-risk long-term investment.

Property crowdfunding may, indeed, be considered less risky an investment than the debt products[70] offered by some early stage companies through crowdfunding platforms. These products are, as debt instruments, included in the Innovative Finance ISA, despite the fact that the FCA has previously expressed concerns about the suitability of these products for retail investors.[71]

For these reasons, we recommend that property crowdfunding should be made eligible for inclusion in the new Innovative Finance ISA. Given that a principal policy rationale for encouraging the property crowdfunding market is widening access to property ownership, the Government should consider whether specific requirements are made of the products in the ISA, including ensuring that minimum investment requirements are not too high.

Help to Buy ISA

Including equity offered through property crowdfunding platforms in the Innovative Finance ISA would give greater confidence to first-time buyers saving for a house deposit that they could reach their target, ensuring that their savings track property prices and that they do not see the relative value of their savings eroded. If their investments fall it will be because house prices have dropped and therefore the price of the home they wish to buy will also have fallen.

However, the Government has accepted the need to go further than simple ISA options to help first-time buyers. In the Help to Buy ISA, announced in the 2015 budget and implemented from December 2015, the Government provides a bonus equivalent to 25% of the amount saved, up to a maximum of £3,000, providing a market-beating rate of return on cash savings. While the bonus can only be accrued gradually – the maximum that can be saved in the account in any one month is £200, after an initial deposit of £1,000 – the bonus will help the purchasing power of savings to keep pace with house prices.

At present, Help to Buy ISAs are offered exclusively as cash savings products through banks and building societies, failing to reflect the choice available to consumers in the broader ISA market. With the government bonus applied only to savings paid in (not on returns to those savings), and with the low pay-in limits, it will take at least 4 years and seven months to earn the full government bonus of £3,000.[72] Given that savers are likely to use these accounts over many years, cash is unlikely to be the optimal investment product either for many individuals or for the wider economy. Property crowdfunding, where most projects have a defined lifespan of five years, could be a good way of boosting returns and making it easier for first-time buyers to accumulate a substantial deposit. For example, if the return on property is twice as high as the current market-leading interest rate on a Help-to-Buy (cash) ISA (4%)[73] – a conservative assumption given that property investment would provide both rental income and capital appreciation – an individual who invested in property crowdfunding could have nearly £1,500 more in their pot after 4 years and 7 months than an individual who saved in cash.[74]

If the Government accepts the natural fit between the Help to Buy ISA and property crowdfunding, it may have to consider issues of liquidity. Consumers are likely to want, and perhaps need, to redeem their investments at year three or year four. For these reasons, there may be an argument to restrict this ISA status to products that fulfil liquidity requirements, such as having evidence of options to redeem investments more frequently than once every five years or a secondary market.

‘Help to Build’

Extending the Help to Buy ISA to include property crowdfunding would help first-time buyers maximise the potential value of their savings and get onto the ladder. However, increasingly, it is not just younger people who are worried about the housing crisis. Older owner-occupiers are also becoming more willing to increase housing supply, perhaps as they see younger family members locked out of the market.[75]

These consumers could provide a useful source of capital to fund new housing developments, given their higher wealth relative to the younger population. In particular, property crowdfunding provides a potential opportunity to direct funding towards small and medium housebuilders who have a less diverse range of finance sources than larger developers, thus limiting their ability to expand supply. Given the market is not yet offering products in this area, additional stimulus may be required.

For these reasons, as the Government pushes for its one million new homes by 2020, a 'Help to Build ISA' could attract new sources of capital to boost housing supply. This could function in a number of ways, including as an additional ISA allowance. It may be possible to fund the additional costs of this tax relief from existing programmes. For instance, money could be re-directed from schemes such as the Builders' Finance Fund, which had only paid out £1m of its £525 million value in the first 18 months of operation.[76] Drawing in capital and letting the market decide where the investment takes place would be a better way to match housebuilders with the finance they need and at speed.

Shared ownership

The premise of property crowdfunding is to enable individuals to buy shares in a property. As such, it fits well conceptually with the more conventional practice of 'shared ownership' in the UK. Shared ownership schemes are operated principally via social landlords although also by the private market. The individual buys a share of the home and pays rent to the landlord on the remaining share.

Despite the attractions of traditional shared ownership, there are a number of limitations. First, the initial capital sum needed to be a shared owner is often significant. For instance, social tenants are required to purchase between 25% and 75% of the value of their property.[77] Second, restrictions also apply to who is eligible to pursue shared ownership in social housing.[78] Third, the share is attached specifically to one property. This has the upside of enabling the individual to establish themselves in that particular home. However, the downside is that the individual may find it harder to exit because the secondary market for conventional shared ownership schemes is limited.[79] Research shows, for instance, that social tenants who are shared owners are less mobile than outright homeowners.[80] Fourth, in order to increase (or decrease) the stake in the property the individual may have to pay for a valuation thus pushing up transaction costs. Fifth, there have been reports that some shared owners face maintenance costs that are not proportionate to their share of the ownership.[81]

In one sense, property crowdfunding may simply offer an alternative product to those who wish to own property but see advantages in owning shares that do not have the features described above. However, there may be broader implications. First, there may be merit in assessing whether large social landlords could facilitate crowdfunding across their own estates. This would allow tenants with smaller amounts of capital to enjoy the benefits of shared ownership. It would also potentially enable tenants to build up (or reduce) the stake in their home (often called 'staircasing') more flexibly. The agreement between the Government and housing associations on Right to Buy (also known as 'Right to Acquire') includes an ambition to make 'available to all [housing association] tenants the opportunity to acquire a stake in a home which can increase over time.'[82] Property crowdfunding should be considered as part of this.

Second, the expansion of property crowdfunding could mean that people are able to own a small part of their home in the private rented sector. Individuals would have significant flexibility to increase their stake over time by buying additional shares in the secondary market from other crowdfunders.

For the reasons set out above, we recommend that the Government should consider the potential role of property crowdfunding as part of its wider shared ownership policies.

This chapter has argued that:

- **Property crowdfunding should be made eligible for inclusion in the new Innovative Finance ISA.**

- **The Government could also consider allowing savers to use property crowdfunding when saving in a 'Help to Buy ISA'.**

- **The Government should introduce a 'Help to Build' product, a new tax-favoured product to incentivise investments in new housing supply.**

- **The Government should consider what role property crowdfunding could have within broader shared ownership policy, both within social housing and in the wider market.**

ENDNOTES

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[3] See for instance, British Social Attitudes survey 2010 which asked the same question.
[4] Source: Data from DCLG, English Housing Survey Households, AT.1, Report 2013-14 (2015)
[5] 4 February 2016. Guardian article reporting evidence developed by the Redfern Commission. http://www.theguardian.com/money/2016/feb/04/young-working-class-home-owners-down-20-under-cameron
[6] There are 7.5 million 25-34 year olds in the UK, according to the ONS's most recent population estimates. According to the 2013/14 English Housing Survey (the most recent data available on tenure by age group), 35.8% of this age group were owner occupiers in 2013/14, equivalent to 3.2 million. By contrast, 59.6% of this group were home owners in 2001/02. If home ownership was still as common amongst this age group, an additional 23.8% would be homeowners, equivalent to 1.8 million people.
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[11] UK savings rate index calculated using Bank of England quoted monthly average of UK monetary financial institutions (excluding Central Bank) sterling weighted average interest rates (1995-1999) and Bank of England monthly average of UK resident monetary financial institutions (excluding Central bank) sterling weight average interest rate, time deposits from households (1999 onwards). All indexed so 1995 =100.Property index calculated using Land Registry house price index, ONS Household Expenditure Survey, Private Rental market statistics, ONS experimental Index of Private Housing Rental Prices and Bank of England Monthly interest on UK monetary financial institutions (excluding central bank) sterling standard variable rate mortgages. This index presents the true return on property, including capital appreciation and net rental income, taking into account bad debt, operating costs, voids (time when the property is vacant), and capital expenditure (repairs etc.).
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[18] Nigel Keohane and Nida Broughton, The Politics of Housing (SMF, 2013)

[19] Alan Holmans, New Estimates of Housing demand and need in England, 2011 to 2031, Town & Country Planning Tomorrow Series Paper 16 (London: Town and Country Planning Association, 2013)
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[21] SMF analysis of housing completions data, table 209: House building: permanent dwellings completed, by tenure, available at https://www.gov.uk/government/statistical-data-sets/live-tables-on-house-building
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[23] IPPR, Capital Future (2015)
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[25] In part at least this is the consequence of 'insiders' (homeowners) protecting their interests, whilst 'outsiders' (non-homeowners) remain smaller in volume and often less vocal.
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[31] Though theoretically they could operate through other mediums.
[32] Although some providers have higher minimum investments for specific property types.
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[41] http://www.crowdsourcing.org/editorial/global-crowdfunding-market-to-reach-344b-in-2015-predicts-massolutions-2015cf-industry-report/45376
[42] While forecasting can offer estimations into the near future and provide longer-term predictions where the number of factors under consideration is very limited, in dynamic policy areas such as housing, where a wide range of economic, social, demographic and political factors are being analysed over long time frames, modelling techniques are inadequate: uncertainties compound and multiply over time and the fundamental relationships between variables that are used to create a forecast will inevitably shift. In this analysis, we acknowledge that important factors may alter and interact with potentially significant consequences. The analysis is designed to enable policymakers to think strategically about the future and what steps to take. In this exercise, we use a ten-year period through to 2026 reflecting that a decade

covers the work of two parliaments, whilst recognising that housing market conditions will not alter fundamentally in the immediate future.
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[47] Department for Communities and Local Government 2012-based household projections to 2037 show average household size falling from 2.33 people in 2016 to 2.27 people 2026.
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[56] In 2015 Housing Association tenants gained the right to buy their homes (https://www.gov.uk/government/news/historic-agreement-will-extend-right-to-buy-to-13-million-more-tenants), while the government has also stopped councils from refusing purchase requests under the Right to Buy and increased Right to Buy discounts (https://www.gov.uk/government/news/33000-new-homeowners-thanks-to-the-right-to-buy)
[57] The Government has only committed to replace some of the local authority housing stock sold through Right to Buy with affordable homes for rent – only additional homes sold as a result of the increase in discounts introduced in 2012/13 will be covered by the promise. At headline level, 12,000 local authority housing units were sold in 2014/15, while only 2,000 new units were built. Replacement of sold housing association properties will take time, creating at least a temporary squeeze on rented accommodation availability, and will not necessarily by like for like (e.g. properties let at social rents could be replaced with Starter Homes (for sale at a discount) or part buy part rent properties). Wendy Wilson & Alex Bate, Extending the Right to Buy (England), House of Commons Library Briefing paper number 07224, 30 December 2015.
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[75] See Part 1. British Social Attitudes Survey 2013, found that opposition to new homes fell substantially between 2010 and 2013, with 46% of residents saying they would oppose new homes being built in their local area in 2010, compared to 31% in 2013. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336769/20140723_Public_attitudes_to_new_house_building_FINAL.pdf
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