Cambridge Centre
for Housing &
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Freedom to succeed: liberating the potential of housing associations

A report for the Housing Futures Network

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Executive Summary

- The social housing sector is operating in a very uncertain economic and political environment. Rapid policy change is underway with reduced subsidy, affordable rents (AR), competition for funds and a restructuring of welfare benefits and incentives, alongside a reworking of the housing and mortgage markets.

- The government's commitment to the free market and reduced public spending presents a fundamental challenge to the very existence of social housing.

- This context sets the immediate future. The forthcoming autumn statement will usher in new funding for growth areas and infrastructure in which housing will play an important part. The issue will be what role for the social housing sector?

- In the longer term funds will come from using existing resources more effectively, enhanced borrowing and new sources of private debt and equity finance.

- The pressure to modify the core mission of social housing continues. Its role was to provide affordable homes for poorer working households unable to afford market rents and prices but over the last 25 years, it has shifted more to vulnerable households. The tensions around who gets housed will increase given the pressures now on lower income employed households whose housing choices have been reduced.

- The elision between social housing and affordable housing is a deliberate blurring and it widens the potential role of the rented sector to the middle ground where it has become a more acceptable or perhaps a more realistic alternative to owning.

- The government's evaluation assumes that those moving to the new affordable rent regime will mainly be households from the private rented sector. In reality, many are likely to come from family homes living with friends or in institutions. This has major implications for the Housing Benefit bill.

- The model of housing assistance is shifting away from heavily subsidised rents more towards income related benefits. It is also becoming more complex - with different levels of assistance and different products depending on household circumstance and time in the sector. Association income streams will become less certain with consequences for investment.

- The offer to social rented sector tenants, especially new tenants, is changing rapidly, making their tenure less secure. Associations will need to do more to support residents and not least their incomes. By doing so they will be protecting and enhancing associations' asset values and cash-flows. Given the worsening distribution of incomes and the rise of unemployment among lower income households it is uncertain whether most of this target population can afford the Affordable rents needed and produce the profits to cross subsidise new and existing social housing provision.

- Given the decline in home ownership, those who traditionally would have owned will be able to afford the new rents; others will not and the question then is about the balance between the different segments and its impact on the sector

- It is equally unclear that HB can pick up the increasing costs while more fundamental changes to the welfare system are delivered. The number of households in defined poverty and reliant on housing benefit have increased in the last 3 years by 750,000. Two thirds of this increase has occurred in the private rented sector, where there has been a 50% growth in the number of tenants in receipt of HB (from 1.054m in late 2008 to 1.57m in August 2011). By contrast, while 62% of social sector tenants in England were in receipt of HB in 2009/10, the number of social tenants in receipt of HB has only increased by 7%, from 3.109m in late 2008 to 3.336m in August 2011.

- The sector has an appetite to do more. But with reduced grant, a limited one size fits all policy framework and uncertainty as to how much additional resource can be levered in from the private sector, capacity to achieve the levels of output required will be restricted. There needs to be a proper debate as to the scale of housing requirements, the capacity to meet them, the costs involved and the role of the different sectors. Seeking a one size for all solution is slow, uncertain and does not generate innovation.

- Looking forward there will be a limited range of funding options. Social landlords could play a central role in bringing in institutional finance to both social and market renting. The current Montague Review of funding for the private rented sector and the consultation on a Social Housing Real Estate Investment Trust are important.

- In the short term, funding capacity will come from increased debt underpinned by AR and from the use of public land. Some local authorities will benefit significantly from HRA restructuring, changes in how public debt might be defined and from RTB receipts. How they will use these opportunities is unclear.

- Longer term opportunities may lie with the potential to re-work grant and treat it as equity; introduce equity finance more generally not least through a REIT structured to work around the social and affordable housing markets and from the realisation of association assets through voluntary sales. Some organisations will seek to use equity, others not. The focus needs to move to encouraging different approaches and allowing organisations to do what works for them and generates housing outcomes.

- Given a likely plurality of funding regimes associations must have flexibility to work across those regimes, maximising housing output in the variety of markets. Policy must encourage associations to make best use of their assets and exploit all forms of funding – debt and equity, revenue and capital grant. There needs to be a new focus on innovation as the norm rather than central control and direction. This might suggest trying new approaches in pilot schemes and trials and here the Scottish Government’s Housing Innovation Fund offers a way forward.

- It remains important to retain Section 106 obligations for social and affordable housing not least because it is an important creator of cross subsidy. Even in the context of CIL obligations, it remains a realistic route for generating significant additional outputs.

- Finally it will be important to ensure that there are mechanisms in place to align the policies of local government with the current and future trajectories of the housing association sector. As it stands there are tensions between the policy direction of central government and what is deemed acceptable by local government. In the future and given the likely funding position, the move towards greater diversity amongst associations could run up against constraints imposed by local government. It is important this is resolved as soon as possible.

- As a matter of urgency the government should consider the following;

    - An independent assessment of the Affordable Rent regime and its longer term capacity to produce homes and cross subsidy. It should also consider the case for a general rise in rent levels across the social housing sector as an alternative to creating an Affordable rent sector with higher rents focussed in some places and not others.

    - A speedy consultation on the social housing REIT regime with a view to bringing this forward for adoption in 2013/14.

    - A full examination of the merits and opportunities that may be presented by converting grant into equity

    - An early resolution of the informal consultation on PFI and an exploration of the possible application of the government's new loan guarantee scheme to the affordable housing sector

    - A detailed assessment of affordable housing requirements in England to 2031 and how these might be met through different funding mechanisms

    - A fuller analysis of the opportunities and constraints on funding recognising the diversity of the housing association sector and its client groups and the need for a mix of funding mechanisms and tools.

    - An agreed framework for the operation of the social housing sector which emphasises freedom from central controls and allows pluralist solutions and maximum flexibility.

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The Housing Futures Network

The Housing Futures Network was established in 2008 to examine the future of social housing in the UK. Its members are four of the largest housing providers in the country, Affinity Sutton, Gentoo, Places for People and Riverside Housing Group and with a good geographic and functional spread. Between them, the member organisations own or manage more than a quarter of a million homes with a turnover in excess of £1 billion and assets of over £10 billion. In 2008 (and updated in 2009) HFN produced *Homes for Tomorrow; New Directions for Housing Policy*. Given the change of government and a change of policy HFN decided to revisit this agenda. In the interim London and Quadrant had moved to commission its own series of reports in conjunction with Price Waterhouse Coopers so this report is supported by the other four members of HFN, Places for People, Affinity Sutton, Riverside and Gentoo. HFN retains its shared ambition to influence the shape and direction of housing policy and not least with respect to affordable housing and as a major contributor to social well-being in the UK.

Setting the scene

> The context for housing associations is probably the most challenging it has been for over forty years. Associations are moving from a world dominated by grant, regulation and direction to a new environment where there is more uncertainty, higher risk, different incentives and in some contexts more opportunity to make their own decisions. Understanding the transition and the emerging opportunities is an essential first step in this process.

Introduction

In late 2011, the Housing Futures Network (HFN) commissioned the University of Cambridge Centre for Housing and Planning Research (CCHPR) to undertake a review of the future of social housing in general and the housing association sector in particular. It did so recognising that housing policy was 'in play' and was concerned that the voice of major players in the sector should be heard alongside the trade body, the National Housing Federation and the myriad of other commentators. HFN was particularly interested in returning to first principles as to what social housing was there to do in addition to exploring new ideas about role and funding.

The work has proceeded iteratively. CCHPR produced discussion papers which have been considered by HFN members along with CCHPR team members. Four short reports on selected topics are provided as annexes to this main report on the CCHPR website. These are:

1. *Demand versus supply subsidy relative costs: a London example by Alex Fenton and Christine Whitehead*

2. *Social housing tenants claiming Housing Benefit whilst in employment: Findings from the Labour Force Survey by Alex Fenton and Anna Clarke*

3. *Mobility and work by Alex Fenton and Anna Clarke*

4. *Local authorities: Housing Revenue Account reform and self-financing by Michael Jones*

Two separate reports on under-occupation and the housing benefit reforms have also been published:

1. *Under-occupation and the new policy framework* by Anna Clarke and Peter Williams

2. *Under-occupation and the housing benefit reforms: four local case studies* by Anna Clarke

This final report is the culmination of the process. It sets out the real tensions that exist around social housing in England - in meeting obligations to those most in need and securing the finance to do this. It also points up the growing gaps in provision, and the impact of the decline in home ownership and the on-going problems of accessing mortgage finance. A new space has opened up in housing provision around this middle ground - the 'can't access social rent and can't afford to own' terrain has grown. But this poses new challenges to providers, who do they house - their current customer base or these new groups or both? Moreover as cuts in housing benefit and a faltering labour market puts pressure on their tenants' ability to pay, so associations have to do more about jobs and mobility to help. In so doing associations are protecting their own income streams.

In all of this there is a core question around the role that social housing and social housing providers should play. With media and government attention directed at welfare reform and the 'undeserving poor' and with a general concern about waste in the public sector, the social housing sector becomes an easy target in this ever more demanding and politicised world. No wonder then that there are increasing pressures on social housing organisations to make the best use of their existing stock and investment potential and also to meet many different objectives from within these same resources.

There is also a question about the role of government. The Coalition has very clearly stood back from some issues arguing it is for the market to resolve them. However it has yet to follow through on this in terms of curbing its own instincts to control and overcoming its reluctance to 'grant' freedoms and flexibility. There is a disjunction here that is becoming a major impediment – government on the one hand saying it can't fund x or y and then on the other constraining providers from taking forward new mechanisms to deal with funding gaps. The government regularly asks for new ideas but it seems to have no mechanism for allowing these ideas to be trialled. .

The purpose of the report is to look not just at the immediate future (much of which has already been set by announced policy and the economic and financial environment) but at the medium and longer time horizons and what is needed to give associations a continuing capacity to develop homes for the next decade.

In detail the report sets out:

- to explore the current and emerging challenges to the social housing sector,
- to review and reflect on the principles around which the sector is based, and
- to consider the opportunities that exist for social housing organisations going forward particularly in relation to role and funding.

The market context

This report has been written in a period of continuing and rapid policy change and against a backdrop of the extremely difficult economic and financial environment.

The balance between households and dwellings has worsened over the last few years and on the evidence this trend will continue. Although household formation has been reduced by current housing market pressures especially in London, household numbers in England alone are projected to increase by over 230,000 per annum from 2008 to 2033. Against this, net increases in dwelling numbers are currently running at their lowest levels since the 1920s. During 2010/2011, only 121,200 homes were made available –this is only around half of the yearly requirement based on government figures.

In 2010 it was estimated that at least 1.5 million households in England and this includes 14% of households in London, are in some degree of housing need, (Bramley et al 2010 – and this excludes need related to the condition of the property . Most of these households are 'concealed' (would-be households living with another household), overcrowded or in otherwise unsuitable accommodation. A smaller but recently rising number is those who are failing to pay their mortgage or struggling to afford their rent (ibid).

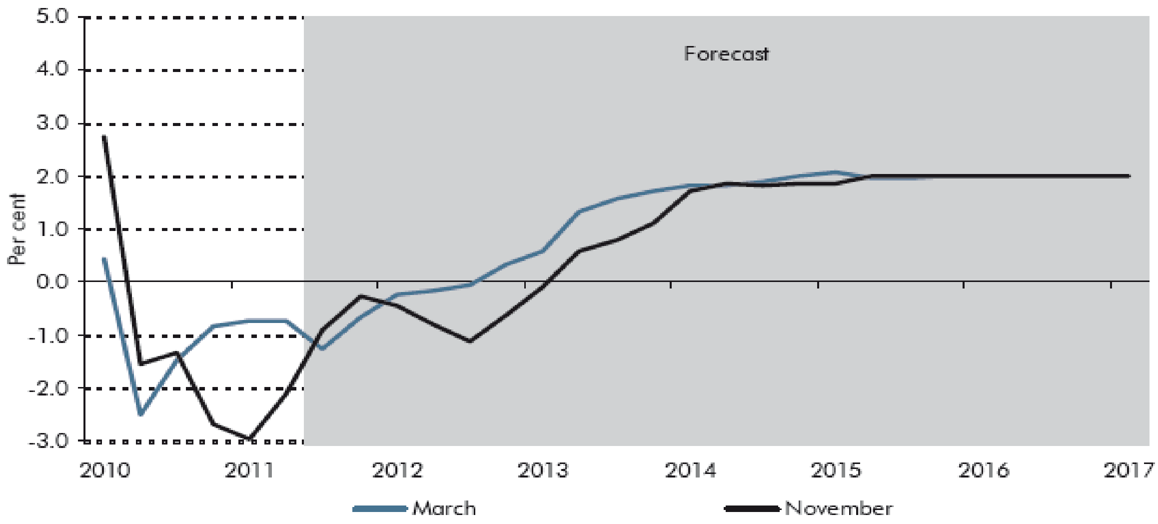
While homeowners with a mortgage have seen the affordability of their mortgage improve over the last couple of years, as a result of lower interest rates, it has done little for households aspiring to become first time buyers. Affordability has technically been improving in the owner-occupied sector – but this applies only to those who have been able to buy. It has not helped the estimated 1 million would-be buyers (Shapps, 2012) become owners because of the shortage of finance, tighter terms and the need for large deposits. The recently announced NewBuy scheme aimed at encouraging higher LTV loans underpinned by a government backed insurance scheme is only available for buying new homes. The plan is to assist 100,000 first time buyers and other households over 3 years. While this may support new development there must be concerns about how big the net effect will be on access to the housing market overall. .

Reflecting these pressures, since 2000 the private rented sector has grown, most significantly at the expense of owner-occupation. Indeed a NHF report produced in 2011 suggested home ownership might fall over time to around 63% - almost 10 percentage points below its peak in England (NHF, 2011a), while Savills (2011) forecast that private renting will expand to 20-23% of the housing stock in England by 2016 (See also CCHPR, 2012).

Rents in the private rented sector have been rising more rapidly than inflation and incomes. So increasing numbers of employed households who rent face significant affordability problems and the numbers of households on partial benefit are increasing. Social tenants have been relatively protected – but the lack of alternative opportunities has slowed outward movement from the sector and with reduced turnover rates the capacity to accommodate more of those in greater need has diminished.

Real earnings growth is projected to be below zero for the next 18 months (indeed average incomes fell by 1% in the last year), and then to rise to around 2% by 2014. Figure 1 below shows forecast real income growth to 2017. Incomes among lower income groups will probably grow more slowly. The 2011 Autumn Statement announced cuts to some tax credits worsening affordability particularly for households with children. Indeed, the IFS suggests that the impact of changes to tax and benefits taking effect in 2012-13 falls disproportionately on those in the lower income groups (the majority of social tenants are in the lower two income quintiles; ONS, 2010) so it is likely that their incomes will actually fall over the next two years. Overall, the context is probably the most pessimistic in living memory and yet the housing policy assumes more private provision and at higher rents.

Figure 1 Real income growth to 2017



Source: ONS, OBR. Annual growth of wages and salaries per employee, deflated by the GDP deflator. Estimates for March forecast adjusted for changes to the ONS' methodology for the process of deflation.

Source

: OBR, 2011

The post 2015 environment, i.e., beyond the current spending round, will be even more challenging than at present – and the examination of longer term opportunities and constraints must take this into account.

The policy agenda

The Government's Housing Strategy for England (HM Government, 2011a) launched on November 21st aims to ensure that as many as 450,000 homes will be built by 2015 although no targets are being set and there may be some 'double counting' (the details of the strategy are discussed in Chapter 5). Housing associations are committed to providing almost 40% of that total and with more than half of these coming through the Affordable Rents (AR) Regime. Other elements of the Strategy include mortgage guarantees for new homes purchase mainly by first time buyers and higher discounts for those wanting to buy their social rented home with the money raised to be recycled to new building. The main thrust of the strategy was to get the house building industry moving again.

The government has already made major changes to housing related policy, notably in relation to land use planning, the regulation of mortgage finance, the ways that government support is made available to housing especially in the rented sectors, welfare and housing benefit reform, the organisation of affordable housing and how best to address problems of homelessness and inadequate housing.

In the context of social housing the immediate trajectories have been set:

- the affordable housing programme is to deliver 170,000 affordable and social homes by 2015; but with continued uncertainty about what happens post 2015.

- the AR regime should generate the funds required – but will increase the Housing Benefits bill. The government assumes most tenants will come from the private rented sector (where they will previously have been getting more benefit) but the evidence to date would suggest otherwise. The higher amounts of private finance required to make up the shortfall in public funds will stretch some association balance sheets and increase the pressure on residents.

- regulatory changes aim to incentivise mobility and improve the utilisation of the stock in both the social and private rented sectors.

Whether the 450,000 increase in the number of homes can be provided over the next three years is uncertain – even if the government further extends its stimulus package to support infrastructure including housing. Rates of starts and completions have been falling reflecting economic uncertainty and difficulties securing mortgage finance. Were it to prove possible to meet the target, it will have been achieved by reducing disposable incomes for tenants, using additional public land, increasing housing association indebtedness and reducing future capacity, transferring social sector stock to tenants and committing developers and lending institutions to the mortgage guarantee fund. In the absence of strong economic growth and a capacity to increase public expenditure these measures have limited long term potential thus raising the question of what policies could replace them?

At the same time an increasing proportion of 'social' tenants (perhaps upwards of 20% by 2016) will be paying rents of up to 80% of market levels - although the average rent in London is likely to be closer to 60% - with associated higher welfare costs and reduced work incentives.

During the 1980s and 1990s the social sector moved more to accommodating 'vulnerable' households with increasing numbers outside of the workforce. This process has been part of the reason why over half of working age households in the social sector are without work. Specific policies aimed at lower income employed households have usually been concentrated in the shared ownership sector. A core issue is therefore whether the emphasis should be on helping the most vulnerable or the most 'deserving' as currently defined?

Conclusions

The context for housing associations is probably the most challenging it has been for many decades. Associations are moving from a world dominated by grant, regulation and direction to a new environment with falling levels of grant at programme and scheme levels, more uncertainty about their role, higher risk, different incentives and in some contexts more opportunity to make their own decisions. Understanding the transition and the emerging opportunities is an essential first step in this process. The next is then to provide the framework to support growth and development.

What is social housing for?

The fundamental role of social housing has been to provide housing at below market rents to those who cannot afford to pay market prices. On the face of it demand side subsidies rather than lower rents (and associated supply subsidies) might be seen as more effective mechanisms and government policy is moving in that direction. Yet there are many circumstances where social landlords can provide better value for money for government and better services to tenants when providing homes using supply side subsidy.

We suggest that by 2015 the overall rented sector will be shaped by a privately owned, for profit sector and that this will increasingly overlap with the social rented sector in terms of who it houses, especially among working people. The social sector will dominate provision of supported housing and specialist housing for older people but general needs provision will increasingly be at affordable or market rents.

Given the worsening distribution of incomes and the rise of unemployment and worklessness amongst lower income households we question whether the rent paying capacity of the target populations can actually deliver the rents needed to underpin a low (or no grant) Affordable Rent regime. Clearly there will be a spectrum of tenants and some will be able to afford the new rents, others will not (or at least not without benefit) and the issue will be the balance between them. If the new regime is to produce the profits needed to generate the subsidy to support new social housing provision, then property sales and conversion of existing rents as properties fall vacant will be crucial. It is not at all clear that Housing Benefit will be able to pick up the increasing cost and at the same time deliver the savings sought as part of overall reform of the welfare system.

There is now the possibility of a serious mismatch between policy intention and direction and underlying economic realities. The recent Housing Policy Statement offered no re-assurance on that because it provided nothing in the way of an overall assessment of the housing situation in England.

Introduction

Social housing has had a long and substantial role in the history of housing provision in the UK. For many decades policy was directed at the dual expansion of social renting and home ownership with private renting being steadily residualised. Over time that has changed, first as the local authority role in social housing provision was shifted from being a provider to being a strategic coordinator, with housing associations taking on the role of providing new social housing, and second with the move away from mass social housing funded by the state to a much more focussed and limited role around providing for those defined as being most in need. While direct government supply subsidies have been central to development, the resources needed to support social housing have increasingly involved cross subsidy from cheap land and property sales whether as rental homes or as low cost home ownership. Indeed in recent years around 50% of output has been derived from schemes cross-subsidised by Section 106 agreements. It is difficult to see where this output will come from in future.

A fundamental aspect of social housing is that rents are held below market levels. Little wonder then that there are queues of people, similarly in need to existing tenants, who cannot get into social housing while a minority of others living in the sector may no longer 'need' a subsidy. This has generated continual tensions around the form and extent of subsidy, allocation rules and priorities and the relationship between need and investment.

Demand versus supply subsidies

In brief, where we are today reflects a journey that began at least as early as the 1970s when income related benefits were introduced and the numerical post-war housing shortage had been overcome. The introduction of income related benefits, when social housing accommodated more than 30% of all households, was linked with increasing rents from an historic cost basis to one more related to capital values. This was the starting point for a shift away from supply to demand side subsidies and for developing ways of sweating the social housing asset (Whitehead, Gibb and Stephens, 2005).

In 1988 the Housing Act introduced fundamental changes with subsidy for new investment being shifted to upfront capital grants along with the capacity to raise private finance while in the 1985 Housing Act (as amended by the 1986 Housing and Planning Act the transfer of local authority stock to housing associations was sanctioned. These changes enabled greater targeting of subsidy and ensured control over public spending along with introducing a mixed public/private funding regime. But it also led to a period of rapidly increasing rents and a continued shift towards demand side subsidies.

The UK has been atypical as compared to other European countries in the extent to which it has relied on both supply subsidies and income related demand subsidies targeted at the same groups of people. In the UK we are seeing an incremental version of the approach adopted in the Netherlands with a rapid shift away from rent subsidies in the form of grant. The current regime continues to provide capital grant but at much lower levels. The longer term objective appears to be to make the social sector almost entirely self-financing, except for equity involvement through public land. At the same time it moves subsidy towards lower income households through housing benefit.

Economic theory suggests that demand side subsidies are more appropriate in well operating markets because they allow tenants to make choices that enable them to use the subsidy effectively to give them the best outcome and because they can be better targeted at those in need. But there are conditions when this is not the case, notably where:

- supply cannot readily respond, so rents rise as a result of the subsidy;
- there are adverse effects on the incentive to work;
- there are additional reasons for helping particular disadvantaged groups; and
- there are other social and economic benefits to good quality social housing notably in terms of supporting local economies and household welfare.

Some of the most important factors which favour supply side subsidies relate to supply responsiveness. In particular,

- it is easier to ensure new building occurs if direct grants or other supply side subsidies such as land allocation and S106 contributions are made. The evidence suggests the supply response from demand side subsidies is sluggish;

- the incentive for housing associations to continue to add to the stock when they are putting in their own funding comes only from their mission to help lower income and vulnerable groups. Demand side subsidies are more uncertain for providers and lenders and reduce both incentives and capacity.

The core of the current government position is not so much to do with inefficiencies but the relative costs to the public purse. The DCLG's Impact Assessment published in relation to the latest round of grant allocations suggests that where the supply subsidy adds to the stock the case for subsidy is stronger based on assumptions that the tenants housed in the additional housing come from a higher rent private rented sector (DCLG, 2011a). Our own analysis, suggests that the relative costs of demand and supply subsidies also varies between areas depending on allocations and particularly on the differential between market and social rents.

The role of social housing

A milestone in thinking around the role of the social rented sector was the Hills Report published in 2007 (Hills, 2007). One of the key features highlighted by Hills was the concern over residualisation of the sector (Monk et al, 2006). The previous Labour government resisted calls to abolish the requirement on local authorities to prioritise those in greatest need for housing, but responded to some concerns by encouraging greater use of local lettings policies. They also said it was not necessary for all properties available to be let to the households in greatest need, so long as overall they received 'reasonable preference' in the lettings system (CLG, 2009; DCLG, 2010). The 2000s also saw the development of a range of intermediate rental and low cost home ownership tenure models, expanding both the type of social housing available, and the client groups it was intended to help.

The role of social landlords has expanded in other ways during the decade. Many social landlords have engaged in significant community investment activity, seeking to address their tenants' wider difficulties in entering the labour market as well as helping them to manage their own finances more effectively.

A further concern has been that local authority lettings priorities obstructed mobility making social tenants less able or unlikely to move to other areas for a job, a factor which, given their high levels of unemployment, the government was keen to address. The introduction of choice-based lettings proved popular in most areas, though the requirement for a local connection and the overall under-supply of social housing meant that, nearly everywhere, it was still need that determined who was housed.

Across the sector, rents were restructured so that they vary more in line with market rents. However, social rents in high priced areas are generally still much lower while in some lower-priced areas social rents are much closer to those in private market housing.

Current policy directions

Social housing has been given a new political direction with several identifiable elements:

- The arguments that social housing should be a tenure of choice has been rejected (Fitzpatrick and Pawson, 2007). The government wishes to see social housing directed towards those in need and ideally only for as long as they are in need.
- The government has set no targets with respect to tenure. However it wishes to see greater reliance on the market where this is cost effective, in part because of greater flexibility and the higher mobility levels observed amongst private renters.
- There is a new concern to address what is viewed as the unfair divide between those who can and cannot access social housing. The way forward proposed by the

government focuses more on reducing the attractiveness of social housing (by increasing rents and limiting security of tenure) than on measures to make the PRS more attractive to tenants. It is worth reminding ourselves that at the same time as Britain has become more unequal, the provision of social housing has been reduced and our reliance upon the market whether via home ownership or private renting has increased. With the fall in the rate of home ownership and the rise of private renting, the position of social housing is put into stark relief.

The social rented sector has seen increasing demand from those unable or unwilling to buy homes and from some who are now unable to afford their housing as a result of unemployment. But it also continues to house very large numbers of working age households who are outside the labour force – a matter of increasing concern to the coalition government.

Increasingly social housing providers recognise they must provide a holistic approach to the provision of housing and related services. To make best use of their property portfolios, to ensure rents are paid and that services can operate efficiently and effectively, most social landlords offer a range of support to households and communities and in doing so helps themselves. There has been a very significant expansion in neighbourhood activity working in partnership with local authorities and others. This covers a spectrum from work on anti-social behaviour to supporting gardening clubs, crèche facilities and employment training.

The Role of Benefits

Given the shift to demand side subsidies the role of benefits is now a crucial issue for the future of the sector. There are large numbers of households who cannot afford the cost of housing. In some cases, this is because the household has no independent income and is reliant entirely on state benefits (which assume currently that housing costs are met separately). A third of social tenants are pensioners, and approximately half of working age households contain nobody in employment (Hills, 2007). Working households' incomes are often insufficient to meet costs, even with the sub-market rents that social housing offers.

Recent data on in-work poverty shows that in 2008/09, the number of children living in poverty where at least one adult in the household was working was 2.1 million. This number has risen substantially in recent years (Parekh et al 2010) meaning that large numbers of households cannot afford adequate housing at market rates. Income distribution in the UK is widening (Hills, 2010) so the situation is unlikely to improve in the foreseeable future. Much is made of rewarding hard working families but the reality is that although some households can afford large amounts of housing, including second homes, many other working families cannot afford to rent or purchase sufficient housing to accommodate themselves adequately. Sub-market rents and/or housing benefits therefore have a crucial role to play.

We would highlight that since the onset of the financial crisis in late 2007, the number of tenants in receipt of Housing Benefit (HB) in Great Britain has increased by 750,000. Two thirds of this increase has occurred in the private rented sector, where there has been a 50% growth in the number of tenants in receipt of HB, from 1.054m in late 2008 to 1.57m in August 2011, an increase of 515,000.

By contrast, while 62% of social sector tenants in England were in receipt of HB in 2009/10 (*English Housing Survey, Table 3.7*), the number of social tenants in receipt of HB has only increased by 7%, from 3.109m in late 2008 to 3.336m in August 2011, an increase of 227,000.

The desire to reduce the HB bill has focused very much on workless households (Fletcher et al 2008; Hills, 2007; DWP, 2010). Available statistical data, however, show that many of those on benefit are in work, albeit often part-time. The number of households claiming partial HB (ie, unable to claim the full amount because of their income) has increased from 10% of all housing benefit cases in 2008 to 16% in 2011 (DWP, 2011b). There may be important regional differences: in London, LB Haringey figures show that while only 25% of council tenants do not receive HB, a further 29% receive partial HB.

Using national data, some 17% of tenants where at least one adult in the households is in work claim HB. Analysis carried out from national survey data (ibid) explores what is known about these households. On average they earn a lower hourly rate than other employed tenants and work substantially fewer hours. A large number are lone parents. The current benefit system means financial rewards for working at all are limited. The substantial numbers who do, suggest that many people may have reasons for wanting to work other than the financial gain but most report that they do not wish to increase their hours. This suggests they may have other constraints on the time they can work (such as childcare duties or ill-health). Policy levers to address their needs may not be the same as those for households without work.

The main issue that is not addressed by these figures is the length of time that households are on HB. The main savings from a demand side product come from the fact that many households do not need assistance at all times in their lives – while if they live in social housing they receive the benefit of sub-market rents throughout their tenure.

Rents and affordability

Rents for housing association tenants are generally far more affordable than in the private rented sector but still take a considerable proportion of household income. Table 1 shows that rental affordability (excluding HB) is lowest in the capital followed by the South East but that the proportion of rent to income on average has remained relatively constant over the decade. Rents for existing tenants have risen by around RPI +1/2%, while incomes have risen slightly faster - so average affordability has if anything improved since 2000 though we should note incomes are now falling.

Table 1: Trends in social rent to income ratios

HA rent / HA income, by region (CORE) Region	2002/03 %	2009/10 %	2010/11 %
East Midlands	36	35	35
Eastern	35	35	35
London	44	48	48
North East	35	34	33
North West	36	35	34
South East	37	37	38
South West	36	33	34
West Midlands	36	38	38
Yorkshire and the Humber	35	33	33
ENGLAND	**37**	**37**	**37**

*Source**:** Banks and Whitehead (2010) and Authors' creation based on CORE2009-10 & 2010-11.*

Figure 2 compares social and private rents. It shows that in some parts of the country, social rents are already close to 80% of market rents. But in the majority of the country social tenants are still receiving a large rental ‘subsidy’ whether or not they are eligible for HB.

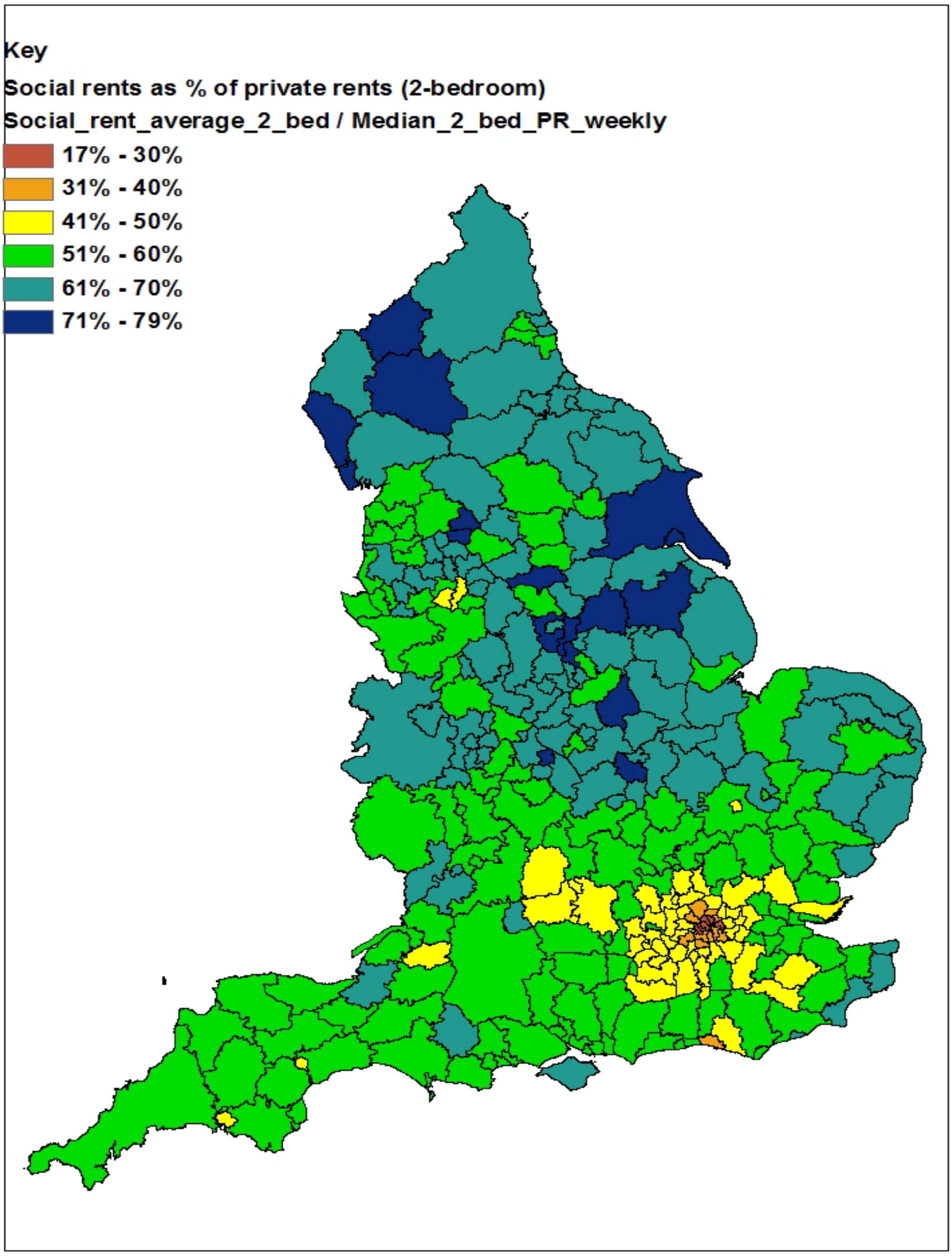


Figure 2: Average social rents as % of average private rents

Source: RSR 2010-11 and VOA 2011

Higher rents are likely to act as a disincentive for people to move into low paid work, or to increase their earnings whilst still needing to claim HB. The number of working households who need to claim partial housing benefit is also likely to increase as those on higher incomes will be required to pay AR.

We have noted already the Government's view that AR will not increase the HB bill because most of the households moving into them will be moving from higher rented private rented accommodation. This evidence for this view is unclear as it is not borne out by recent HB claims. Tenants moving into social housing come from a variety of backgrounds. Figure 3 shows the previous tenure of households moving into the social rented sector in 2010/11.

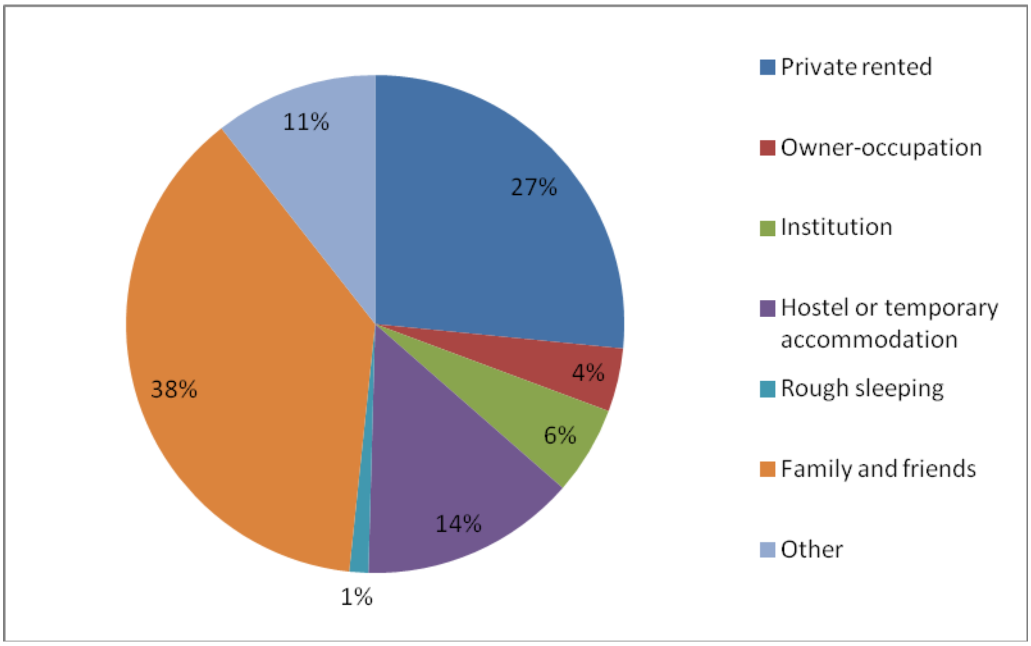


Figure 3: Previous tenure of new tenants, excluding transfers within the social sector

Source: CORE 2010-11

These data suggest that only just over a quarter of new tenants move from the PRS. A further 20% move from institutional or temporary accommodation, where there are likely to be costs to HB. However the largest group, 38% were previously living with family or friends. These are essentially new households forming and would be unlikely previously to have been in direct receipt of HB. The impact on government expenditure could thus be greater than suggested by the published assessments – putting further pressure on welfare reforms.

This might suggest that rather than rely on one mechanism – demand side support, the government should develop a clearer sense of where the pressure points lie and how best to deliver subsidy to them. In essence we would argue for a more pluralistic approach than that currently being adopted.

Who should the social housing sector help?

Many working households are paid very low wages. Getting access to good quality affordable housing remains a problem for large numbers of people. Some are dependent entirely on state support, others work but cannot afford to meet even social rents without assistance, and others are unable to afford to rent at market prices. There is also a substantial group of would-be first time buyers who cannot raise a sufficient deposit, or borrow sufficient money to purchase their first home. Some of these can afford to rent privately without assistance, others cannot.

Different levels of assistance, and different products, are needed to meet the needs of these differing circumstances. It is also important to remember that people may move between these differing situations over time. People who are out of work may find work; others may lose their jobs. Marriages end and single people form new relationships or remarry. Children are born, and young adults leave home. All these changes affect the level and type of assistance that households need to secure adequate homes. The government has given little attention to both the scale and the diversity of needs. With a pre-occupation with new homes as part of an economic strategy there seems to be less interest in who is being provided for. Both are important and while there is growing recognition of the importance of housing investment as an economic multiplier, it is also important to seek to satisfy the range of housing preferences and needs.

Against this backdrop of individuals' circumstances, there are overall trends that can be observed including: greater longevity, an increasing population and even faster-rising numbers of households.; more people live alone; and in the older age groups more live independently, and in owner-occupied housing, than in the past. These changes are likely to affect the types of support required. Housing associations have for years been reducing their stock of older people's housing with features such as shared bathrooms. New housing is instead built as potential "lifetime homes" with space to adapt for wheelchair use if needed. The rise in the number of single people has not, however, translated into demand for one bedroom properties, as most single person households are in the middle-aged to elderly age groups and prefer to remain in homes with two or more bedrooms. Younger single people are increasingly unable to establish independent households so may remain at home or in shared accommodation (Bramley et al, 2010).

The decision over who needs help, and how housing associations should best use their resources to help them has never been more open. The government is widening the range of products available, but the decision over which to pursue depends to a large extent on decisions made by housing associations and local authorities.

The social housing 'offer'

Traditionally, the housing association general needs 'offer' has been:

- A home with reasonable space and amenity standards and in a fair state of repair
- Let with reasonable conditions of tenancy and with lifetime security of tenure
- In a regulated sector with effective redress mechanisms
- Let to households in housing need (however defined)
- By a not-for-profit landlord at sub market rents

With minor variations, this offer has evolved from the norms established in the council housing sector during its large scale growth from 1920 onwards. The 'offer' is changing in the light of the new policy stance, impacting on rents, eligibility, tenancies, allocations, definitions of housing need and the landlords themselves. Rents will be more directly linked to property values – ie market relativities. They will as always be set to ensure that the non-profit or public owner can break even and meet prudential requirements but also to enable existing assets to be recycled to increase the overall supply of affordable housing.

The rate at which properties can be converted to AR will be a major element in determining funding capacity. The new market driven philosophy sits uncomfortably with the current administrative regime which requires annual administratively driven uprating and a convergence formula aimed at bringing local authorities rents closer to those of associations by 2016. It is not clear at this stage how these two regimes are meant to interact.

It is still not possible to estimate accurately the proportion of social housing that will be let at AR by the beginning of 2016/17. Nevertheless, turnover rates in the housing association sector based on CORE, suggest that up to half of 1 bedroom units (12% turnover per annum), over a quarter of 2 bedroom units (7% turnover per annum), but less than a sixth of 3 bedroom and larger units (4% turnover per annum) might have turned over.

This would suggest that perhaps up to a quarter of the stock could be let at AR by the end of 2015/16. The actual proportion is likely to be lower, reflecting transfers, lets and relets which remain as social rent and the growing proportion of subsequent relets among the recent conversions to AR. In addition a large proportion of the government's anticipated 170,000 new build completions will be let at AR.

Tenancies

Hitherto, social housing has generally offered an effective lifetime security of tenure for both council and housing association tenants, in recent years following a probationary period. In 2011/12, housing associations taking part in the new investment framework will let their new lets, and a proportion of their relets, within the AR regime, and may also let properties on fixed term tenancies. From April 2012, housing associations are able to make all relets to new tenants on fixed term tenancies.

The NHF briefing paper on the new tenure arrangements (NHF, 2011b) suggests that the principal use of fixed term tenancies may be to allow landlords to respond to under-occupancy in the future. This links to changes in the benefits system by which tenants of working age will have a reduction in housing benefit if they occupy larger units than they are deemed to need. The NHF paper also suggests that landlords are unlikely to use the expiry of a fixed term tenancy to require better off tenants to leave the social housing sector as few will have much improved incomes.

Allocations

The 2012 Welfare Reform Act's restrictions for HB of working age tenants who are under-occupying their homes are also likely to have a significant impact on initial allocations and lettings. For further details of our analysis of the impact of these reforms, see the accompanying Facing the Future publications, *Under-occupation and the new policy framework* (Clarke and Williams, 2011) and *Under-occupation* and *Under-occupation and the Housing Benefit Reforms: Four local case studies* (Clarke, 2012)[1].

At present, a third of all housing association lettings of 2 bedroom properties are to single people or childless couples, as are 3% of all lettings of 3 bedroom properties. Housing associations (and local authorities) are therefore likely to face problems in allocating to the 'required' size unless they substantially alter the profile of those they accommodate; allow pensioners or non-HB claiming households to under-occupy on a larger scale than previously; or enable HB tenants to choose to pay the additional cost if of course they are able to.

[1] www.cchpr.landecon.cam.ac.uk/outputs/detail.asp?OutputID=266

Downsizing

There are over 400,000 social tenants who are under-occupying their homes by two bedrooms or more (as measured by the Bedroom Standard). Despite guidance on good practice and most social landlords offering opportunities for tenants to downsize, the number of under-occupying transfers achieved remains relatively small. The government has attributed this to reluctance by tenants to move given their current effective lifetime security of tenure. Other reasons include the lack of good quality options and the relatively small differentials in rents between property sizes.

In an attempt to incentivise under-occupying tenants to seek to downsize, the Welfare Reform Act has specified that, from April 2013 social tenants of working age with one or more spare bedrooms (defined according to the bedroom standard) will have their housing benefit reduced by a fixed percentage. The government's impact assessment calculates that the average reduction for tenants with 1 room over standard averages £11 and for those with 2 or more, £20. The impact will be much higher in London.

The DWP's impact statement calculates that 670,000 households will be initially affected rising to 760,000 by 2020 as the age limit rises in line with women's pension age (DWP 2011a). The biggest group hit are middle aged tenants whose children have left home; however the DWP analysis showed that a third of those affected are households with children. A sample survey of affected tenants showed that a third (32%) were likely to try to downsize in response. However, the restricted availability of suitable vacancies would mean that it would take many years to accommodate this group of 180,000 seeking to downsize in the social sector's own stock, when annual vacancies total around 86,000 for 1 bedroom dwellings and 92,000 for 2 bedroom dwellings (see Clarke , 2011).The sample survey also found that nearly half (42%) of under-occupying tenants felt that they would be neither able to downsize, nor able to make up the loss of HB from their remaining income, and foresaw themselves as falling into rent arrears.

The consequences to housing associations of this new exposure on rents could be considerable. First, there is uncertainty at present as to whether such households will lose any rights under homelessness legislation given their arrears. Second, there are potential knock on effects on the cost of capital and the capacity and incentive to build. Associations have begun to seek to mitigate the effects of this new regime through better information sharing arrangements and offering appropriate vacancies to tenants who need to move regardless of which association currently houses them. However, in many areas, the number of tenants affected will mean that most cannot be helped to move to smaller properties for many years (Clarke, 2012).

Definitions of housing need

There are a range of initiatives to shift responsibilities for accommodating households in need. The Localism Act 2011 makes provision for local authorities to determine which 'classes of persons' are eligible to be included on the housing waiting list (for example, a local authority may decide that only households with a 'local connection' qualify). Direct lettings by housing associations are not affected by the Localism Act. Clearly there are possible tensions here with the agenda around increasing flexibility and mobility and this gives further momentum to the potential gaps between where housing associations are going and where local authorities might want them to be?

The Act also gives local authorities the power to discharge a homelessness duty by making an offer of accommodation in the private rented sector although it is not clear how willing private landlords will be to accept such nominations, given the constraints on Local Housing

Allowance. Nor is it clear how higher private sector rents can help reduce overall housing benefit costs.

The government recently consulted on plans to increase powers of repossession for anti-social behaviour or criminal conviction, although this has now been restricted to offences committed at the scene of a riot. Pursuing the same theme, that social housing constitutes a 'privilege', the government is consulting on provisions to raise rents for higher income tenants, suggesting that there may be as many as 6,000 tenants with household incomes in excess of £100,000. A consultation paper on this issue has recently been issued (DCLG, 2012), with the possibility of household incomes of over £60,000 being considered as sufficient to result in higher rents. Social landlords have expressed concern over the new role that would be expected of them in keeping track of the incomes of some four million households.

Blurring the sectors

The regulatory framework introduced by the previous government allowed for the registration of for-profit providers, and a few have already been registered. A small number have won contracts under the new AR regime – but so far their impact has been extremely limited. Far more relevant is the role of private landlords and housing benefit in providing market rented housing for households in need of assistance.

By 2015 the tenure ratio in England between owning and renting could have shifted to perhaps 62:38, ie, significantly different from the 71:29 in 2005. Given expected social rented development over that period the rented sector might then be split in a ratio between a privately owned, for profit, sector and a social, not for profit, sector of perhaps 55:45.

The two rented sectors have some clear differences, but appear to be housing an increasingly overlapping population, particularly among tenants of working age. A probable scenario post 2015 is one of increasing convergence between the private and social rented sectors. The social housing sector would remain the only major institutional force in the rented sector with access to the capital markets though this may change and not least as a consequence of the revised REIT regime and any outcomes from the Montague Review.

Conclusions

The fundamental role of social housing has been to provide housing at discounted rents for those who cannot afford to pay market rents. On the face of it demand side subsidies rather than lower rents (and associated supply subsidies) might be seen as more effective and government policy is once again moving in that direction. Yet there are many circumstances where social landlords can provide better value for money for government and better services to tenants when providing homes either at social or AR using supply side subsidies.

We suggest that by 2015 the overall rented sector will be dominated by a privately owned, for profit sector and that this will increasingly overlap with the social rented sector in terms of who it houses, especially among people of working age. The social sector will dominate provision of supported housing and specialist housing for older people but general needs provision will increasingly be at affordable or market rents.

Given the worsening distribution of incomes and the rise of unemployment and worklessness amongst lower income households we question whether the target populations can actually afford the rents needed to underpin a low grant, Affordable Rent regime which relies on profits to cross subsidise new social housing and sustain current provision. Segments of the tenant population will be able to afford the new rents, other segments will not and the question then is about the balance between the different segments and the impact this has on the role of the sector. It is equally unclear whether HB can pick up the increasing cost given the government's desire to reduce its costs.

There is now the possibility of a serious mismatch between policy intention and direction and underlying economic realities. The recent Housing Policy Statement offered no reassurance on that because it provided nothing in the way of an overall assessment of housing need and supply in England (DCLG, 2011b).

Funding new homes

There is no easy and immediate solution to the funding constraints that exist. Clearly there is some real capacity– the new borrowing power of some local authorities; the increased cashflows generated by the AR regime; the possibility of using public land; and the potential for bringing equity finance into housing provision. Taken together these could generate a capacity to fund a significant development programme, though whether it can exceed what was achieved under the grant regime is questionable and it would certainly be less geographically spread. If it were built in part through partnerships with local authorities, builders and investors, risks could be shared and capacity increased. Far from being a one-off, there is the potential here in combination to build a long run and sustainable increase on the low level of output currently being achieved. To achieve this the framework needs to allow a diversity of responses and to encourage greater innovation.

The probability is that opportunities will develop slowly; so we face the tension between the run-down of the tried and tested grant regime and its replacement by an alternative approach. Undersupply is thus likely to characterise the market, especially in London and the South East into the medium term which, while undesirable in many respects, underpins values and rates of return. This might prompt other providers to enter the market and associations could consider how they will respond and partner with new entrants. In our view this could generate further opportunities that might allow the level of activity to rise more sharply.

The continued uncertainty as to the future of the Section 106 regime and the limited impact of the New Homes Bonus (NHB) to date along with the fundamental changes in the planning regime are important concerns. The evidence suggests S106, reduced already by economic circumstances and scheme viability, will be reduced further as a consequence of the new CIL regime and confusion continues regarding what is being achieved under NHB.

The Issues

With continued unmet demand, a falling rate of new supply along with a withdrawal of both supply and demand side subsidies by government, there is a worsening housing crisis of significant scale. The question then is what mechanisms outside of the established mixed funded regime might be drawn upon to begin to create an alternative regime that can deliver homes in the required volume. This requires a careful examination of where we are and what options might exist (see BDO, 2012 for a recent survey of housing association executives' views of funding options).

The introduction of the NewBuy scheme to assist first time buyers and others to purchase new properties with only a 5% deposit indicates the government acknowledges the need for more new homes. There has also been significant funding given to housebuilders to increase housing supply but little sense that government feels 'responsible' for ensuring that increased supply is actually delivered. Its focus is on market incentives. Given the poor history of housing supply in England in recent years we would question whether this is sufficient.

The current regime for housing associations was brought in under the Housing Act 1988. This allowed HAs to borrow against capital values and increase rents to develop new housing. Capital grants were available on a competitive basis. The objective was to reduce capital grants from close to 100% in some cases to an expected 50%. During the early years rents were allowed to rise quite significantly (at the cost of the Housing Benefit bill) partly to build up reserves to reduce the costs of borrowing (Chaplin et al 1995) and also to meet the costs of major repairs. However, by the mid-1990s, it was argued that rents had risen to the point where the increase in the housing benefit bill matched any returns to government and rent increases were controlled through a new 'rent restructuring' regime which was also designed to align the rents of housing associations and local authorities. Grant did not fall as far as some had initially predicted and new supply continued to depend on significant levels of government support.

The new regime is in many ways a return to the 1988 principles: rents are to rise to enable HAs to borrow to invest with lower grants, while housing benefit takes part of the strain. The evidence base developed by the last government suggested that there was headroom for this approach. Private developers now compete for grant on equal terms with HAs and LAs. Since the financial crisis, developers have found affordable housing for ownership less risky than the market as it can provide an early stream of funding and so use their limited capitalisation more effectively. Many have also been involved in HomeBuy Direct and now FirstBuy and NewBuy which involve developer equity. Housebuilders are therefore likely to wish to continue to partner with associations.

The New Affordable Rent Regime

The government's objective is first to create a competitive system for the much more limited funding now available, encouraging housing associations to borrow a significantly greater proportion of private debt. Second, it is to link rents closely to market values and to use that rental income to support new building and therefore recycle past subsidy more effectively. Although this is the path government wishes to go it is clear not all local authorities agree and again housing associations are finding some authorities opposing conversions and disposals related to affordable rents. This tension clearly needs resolving.

The direct costs of new investment must ultimately be paid for out of rental income. The costs that rents must cover can be reduced by government subsidy (now in the form of capital grants - but with the possible intention of phasing out or further reducing all such general subsides after 2015). The subsidies available to reduce the costs of new investment include public land at below market value (usually by maintaining a leasehold interest) or the use of S106 as a means of reducing the value of land - the potential availability of the first is being increased but funding from planning gain has declined because the financial crisis has limited the appetite of developers to build out sites with housing for sale. Moreover, Section 106 contributions will be reduced as the CIL comes to dominate and as housebuilders set up their own registered providers to capture this benefit. Costs can also be reduced by cost efficiencies and cost reductions resulting from freeing up the planning regime.

The other major cost is the interest rate to be paid on borrowing which reflects market conditions and the security of the rental income – including the availability of income related subsidies. In principle social rented rental income should carry a risk assessment similar to other utilities – but there are at least four reasons why that assessment may have changed (Standard and Poor's, 2011):

- uncertainties around the HB regime;
- the possibility of payment direct, which will make it harder to collect the rents;
- the potential for higher void rates as rents rise and competition increases especially in lower demand areas; and
- uncertainties related to the new regime which pays out subsidy in equal instalments while the HAs' claims on that subsidy depends on the throughput of affordable homes

Indeed in February 2012 Moody's took the decision to downgrade the outlook for housing associations from stable to negative following their downgrade of the UK Sovereign outlook. This decision reflected the important role the UK Government plays in underpinning housing association credit ratings (Moody's 2012).

Under the new affordable rent (AR) regime potential providers bid for grant in proposals that spell out the delivery of homes of different types and locations, including evidence on internal cross subsidy from conversion to AR and property sales, how rents would be determined and financial viability. The DCLG Impact Assessment which is based on the assumption that new and a proportion of relet properties to new tenants would be let at 'affordable' rents, makes it clear that the government sees increasing output levels against a pre-determined subsidy budget as the first priority. Thus the capacity to borrow more and to build more efficiently generates the highest value to government.

The evidence suggests that registered providers are prepared to support investment from their own funds (including using RCGF) as well as by increased borrowing – indeed there were more bids than have been contracted. The programme of 80,000 AR units includes: 27% of the units in London - in line with the allocations since 2007; 29% of family sized homes with 3 plus bedrooms; and 10% of supported dwellings.

Most of the 170,000 new affordable homes to be built over the next three years (including the 80,000 AR units under the new regime and the balance via the previous mixed funding regime) will be developed by housing associations. Part of this is possible because of the one-off adjustment up to 80% of market rents as existing homes are switched from social to AR, bringing in significant revenue which in turn can support new borrowing. A perhaps less obvious impact of the new regime is an uplift in values derived from the AR regime. This should support new borrowing although lenders and valuers have been cautious in their approach to the AR regime to date.

The new regime brings higher risks and there is concern this might then be reflected in borrowing costs and reduced funder appetite. Recent wholesale and retail debt issuance by the sector suggests housing associations remains attractive - although given the very large increase in margins required by lenders after the credit crisis, it is difficult to estimate longer run equilibrium rates. There has been a reduction in the number of active debt lenders, loan terms have shortened and we have seen increasing use of the bond market.

Funding options for the future

Given the current situation, with constrained public finances now and in the foreseeable future, there is a premium on rethinking how we fund affordable and social housing. The number of lenders is limited, their back books are loss-making and there is a constant tension around terms and re-pricing.

Going forward we see debt finance provided as short term finance, while long term finance will come from the bond market. Associations have already expanded their bond financing and used other sources including private placements and in one case retail bonds to raise finance.

A report for the HCA (Williams et al, 2011) set out a number of ways forward, including private placements by pension funds, the appetite for and the issuance of index linked bonds by associations, the creation of new private residential investment vehicles on a stand-alone and partnership basis and much more. What is evident is that there is a lot of innovation underway, mainly around private renting but with the potential either to create profits to cross subsidise social housing or to include such homes in the developments. The recent House of Commons CLG Select Committee report on financing new housing supply (CLG Select Committee, 2012) provides a valuable update and we support their recommendations for urgent action.

Opening up the institutional investment market remains a key theme for government and without doubt there is considerable synergy here with a regulated social rented sector. The new review of funding for the private rented sector being chaired by Sir Adrian Montague will be important here. Institutional investors are active purchasers of HA bond issuance and the question is now whether they have the appetite to go further and make direct investments in the sector? Investors, especially pension funds, need to be assured of adequate returns to meet their liabilities. There is some evidence to suggest this may be possible, eg, the Derwent Living partnership with AVIVA.

The Potential of the Affordable Rent Regime

AR will almost certainly not increase borrowing capacity in direct proportion to the percentage increase in rents. Lenders will be conservative in their response; some may treat developments at affordable rent levels as more nearly akin to commercial residential development, and to price loans and fix covenants accordingly. The Savills report '*Viability and Vitality*' (Savills, 2011) sets out a number of the issues surrounding the AR regime and the risks that need to be managed, especially in understanding local markets. The formula driven rent regime that has operated for over a decade is a poor starting point for this.

The extent to which rents can be raised depends in part on the existing ratio between social and private rents. Using average HA and private sector rents at the lower end of the market, London social rents are less than 50% of market levels, while in the North East they are nearer 70% (Banks and Whitehead, 2011). At local authority and individual property levels the variation is far greater. At the limit some households in the smallest properties are paying close to or even over the market rent. Given changes in LHA eligibility to cover only 30% of local market rents, the differences undoubtedly over-estimate the extent of the gap. Equally, private rents may fall because of the lack of HB cover (although the early evidence points to private rents increasing overall). In many lower rent areas (notably in the North East but also in the Midlands) there will be limited capacity to continue to increase rents across the stock and thus add to borrowing capacity. There is a clear need for detailed quantification of the operational headroom for individual associations and this will be complicated by fluctuations in rents in the PRS – a recent Paragon survey indicated that many landlords were finding rental income was static (Paragon, 2012).

Local Authorities and Private Registered Providers

The overall effect of the self-financing reform of the HRA system is to cut local authorities free from the former subsidy system. Their position is similar to that of housing associations, but with significantly greater constraints.

171 local authorities in England have retained their council owned housing stock, and therefore have a Housing Revenue Account (HRA). The previous subsidy system was slightly in surplus, with the surpluses of around 140 local authorities slightly exceeding the deficits of around 30 local authorities (nearly all larger metropolitan authorities). Now each local authority has exactly the amount of debt that can be serviced by the excess of rent income above the expenditure allowances. Some local authorities have a limited 'headroom' for additional borrowing.

Two aspects of the new regime incentivise housing development by LAs:

- the application of the AR regime to local authorities will enable local authorities to compete for any remaining SHG against other registered providers; and
- the local authority retains 100% nomination rights in perpetuity in its own stock, which gives a significant incentive to local authorities of all complexions to develop directly.

But there are disincentives including:

- the self-financing regime makes no allowance for debt repayment so all new investment must be either self-financing or cross subsidized by other activities;
- under the new system, any change in interest rates will have to be met directly from the HRA with associated risks in debt and treasury management..
- authorities remain constrained by central government controls on total local authority borrowing, with each HRA allocated a debt ceiling. Income has to be generated to pay the interest payments.
- authorities can raise rents above the annual guideline rent increase (which will remain in place in the new system), but any additional HB cost must be met from the additional rent income raised.
- although the government has raised the discount cap for Right to Buy sales, it remains unclear whether this will add significantly to the resources available to support additional replacement new build.

Local authorities that wish to develop must raise funds. A number of authorities have indicated a desire to raise capital market bond finance on their own or in a 'club' structure as an alternative to borrowing from the Public Works Loans Board (PWLB is part of the Debt Management Office). It is estimated that there will be a self-financing capacity of £2.87 billion overall but £1.66 billion of this is focused into 28 authorities, mainly in London. The PWLB has remained the preferred funding choice for some time and indeed in the Budget there was an offer of discounts against normal PWLB rates if local authorities were transparent with their plans. This suggests limited competition with housing association funding requirements.

The PWC/L&Q report *Where Next* (2011) calculated a forward funding requirement for housing associations of some £24 billion, equating to 30% of all bond finance raised in the UK over a four year period. It asked whether given possible LA fund raising this will be achievable – the evidence suggests this is fundable although pricing will be determined by how investors see the credit worthiness of individual borrowers in a regime which is more risky.

Those authorities that have already divested themselves of their housing will wish to continue to work in partnership with housing associations, although they may put stronger constraints on allocations and on acceptable rents. Those who still have ALMOs or their own stock can be expected to be more proactive but none have an operational development arm (as opposed to a maintenance arm) so will again be likely to choose to partner with developers or to form broader partnerships as elements of an urban renewal strategy. Authorities may wish to use their own land and might attempt to put additional constraints on S106 contributions in the light of their new capacities.

Local authorities will approach all of this with considerable caution and that there will be no dramatic shift over the short to medium term. There will be individual authorities, typically some larger ones, with appetite and capacity to engage.

Housing association potential for new development

Alternatives to the new regime which offer up the potential for more development have also been canvassed. Several organisations and groups have suggested raising all rents by a relatively small amount. However this is currently not on the government's agenda in part because it would necessarily be voluntary and would carry a 'dead-weight' cost if applied by non- developing associations. The recent PWC/L&Q report not surprisingly, argues for greater operational freedom for associations using a household net income measure of 35% and converging rents to this measure (and thus more flexibility around rent setting). On this basis and by converting 50% of social homes to full market rents it is suggested an additional £25 billion of funding capacity would be released. Clearly this would pose HB questions but the report argues that it would see AR averaging 55% of market rates rather than the government's current planned 80%. Additional income can support additional borrowing but there will be gearing constraints and associations vary considerably in the scale of their current borrowing set alongside the value of their stock.

Growing the social housing business through development?

New building in England is now only around 100,000 per annum, an annual addition of less than 0.5% to the existing stock of homes. Within this total some 22,000 were for housing associations and local authorities. The remaining 76,000 were recorded as private enterprise but include completions acquired by housing associations from housebuilders. There has been a significant shift in output, away from 1/2 bedroom homes towards larger homes.

At the present time the impacts of the New Homes Bonus (NHB) and, further into the future, the presumption in favour of sustainable development, are unclear. The 2010/11 NHB of £233 million was paid in respect of 159,000 homes (this included 22,000 long term empty homes brought back into use). The amount paid was up by £33million on the Year 1 bonus of £199 million suggesting more homes were produced but there is considerable debate about the current statistics with NHB payout figures suggesting far higher number of new homes than the construction figures support (the NHB figures include empty homes and conversions but the DCLG release only gives the amounts paid to local authorities and avoids stating the number and source of homes provided). An *Inside Housing* survey of local authorities suggested that more than 70% of the NHB bonus cash has gone directly into the General Fund rather than been spent on housing or infrastructure although it may still be used to facilitate further development (and it is important to remember that NHB was never seen as a source of direct funding for new homes). The NHB regime will have distributional impacts in that it will have limited leverage in more affluent authorities as well as ultimately being funded through a top slice of the support grant to local authorities.

In response to falling supply and pressure from house builders some local authorities are removing or reducing S106 requirements for affordable housing. In response to local pressures they are also reducing the emphasis on development. Anecdotal evidence from associations suggests increasing short run difficulties with respect to planning permission for specific sites. These pressures could further restrict the capacity to exploit the potential of the sector. In addition, the unclear relationship between CIL and S106 is generating uncertainties for LAs and HAs alike.

Reworking grant and bringing in equity

In the search for new resources to support an expanded development programme the existing housing association asset base (primarily housing stock) has been the focus of much attention. The stock in England has a historic book value of £95 billion compared to an estimated open market value of £250 billion. Although various devices have been used to edge up the base value these are marginal in relation to the potential of accessing the full open market value. However this is not as easy as might be suggested because:

- Some lenders argue that the potential open market sale value is already taken into account in their own lending terms
- The realism of accessing open market value is highly questionable
- There is an outstanding liability of £35 billion of grant which may have to be repaid although it could be recycled.

On this last point there is an active exploration underway around how grant might be reworked. One view is that it could involve re-designating existing social housing grant that currently sits on the balance sheets of associations as an unsecured liability and turning this into an equity investment with an income stream derived from higher rents thereby providing a return to an investor. Associations, having established a track record for servicing equity investment, could then raise further equity finance in the market and this could be used to fund new development.

Again there are arguments about the principle as well as the impact. Some lenders suggest that removing the grant from the balance sheet equation or indeed turning it into an equity holding on which a premium is paid will impact upon the capacity of associations to raise and service debt although the funding of LSVT associations does suggest different views can be taken. Equity ranks behind debt and this may provide some comfort to debt lenders. Assuming this concern can be settled - there would be £35 billion of repaid grant that could be recycled in some way. This could underpin a substantial development programme. Current grant liabilities are not evenly spread and a universal move to higher rents to provide a return may lead to windfall gains by associations that have done little development. Regulation similar to that adopted by utility regulators could prevent this by allowing only those who agreed to invest to adopt the equity approach in a similar way to the affordable rent contract. There would also be housing benefit implications and costs. .

Liberating historic housing grant is an important avenue for exploration and one that requires detailed work and consideration. However there are important underlying principles about ownership and control and clearly not all of the sector would want this nor be able to sustain the dividend costs. Charitable associations would face particular difficulties but a number of the large associations that are comparable in size to FTSE 250 companies might. The key point is that this approach should be explored and piloted to become part of a toolbox of approaches to generate additional housing.

This tension between such associations that are in effect outliers in the sector (albeit very important ones) and the sector as a whole are important points for consideration. This again argues for policy and funding models that respect the diversity of business models that exist in the sector and the need for a move towards a much more pluralistic framework. In essence we need to move away from a one size fits all approach.

As already noted, within the sector as a whole there are many associations that could not and would not wish to follow this path. Some might look to consolidation and transfer as a way forward. Given the search for more for less, a key concern for government is to find ways of encouraging or forcing better use of existing assets in both non-developing and developing associations. Consortia structures help a little here but more needs to be done. Options canvassed to date include making hostile takeovers possible and clawing back grant but neither have really progressed and neither address the question of how an association that has unused assets, limited or no grant and no ambition to develop can be forced to the table, a point we return to later. The Charitable and Industrial Provident Society status of most associations is a powerful obstacle to moves in this direction

The geography of the capacity of different landlords whether housing associations, stock transfer associations and local authorities varies hugely. Again this reflects history and bears little relationship to current need and demand. For associations and HFN in particular, active engagement with LA/LSVT organisations in their operating areas, exploring and discussing opportunities would seem to be a priority as a way of managing potential competitive threats and using combined balance sheet capacity to best effect.

The HA asset base (along with the asset base of all social landlords) is thus coming under increasing pressure. Developing associations are exploiting that asset base more effectively than non-developing associations. Mergers, partnership and consortia offer some devices for extending that reach and drawing in more under-exploited assets. Given the history of associations and their funding there will be some sector limits on how much might be raised against the total HA asset base but clearly there remains substantial potential.

For some providers one interesting area is the exploration of the IFRS accounting standard. While there are risks as well as advantages, past grant can be held as a contingent liability allowing RCGF to be recycled as well as creating a framework for the introduction of equity. Ideas such as this need to be considered and if the case is made they can be trialled.

Increasing capacity and dealing with ‘deadweight’

As touched on above, one of the difficulties in moving to a new higher rent driven regime is the ‘deadweight’ costs of associations that then do not use the increased rental income to undertake new development. A significant number of associations, most obviously the smaller ones that do not develop, hold large reserves and have received subsidy in the past. This can in principle be addressed by a claw back mechanism although without doubt this will be complicated to administer. Alternatively it might be possible to introduce an incentive based system so that those who have an active development programme operate under a different regime than those who don’t – one suggestion is that the RPI rent formula could be varied to reflect this with developing associations getting a higher rate. It might be possible to take these ideas forward through agreeing pilot schemes subject to a proviso about increasing greater housing provision. In principle, a new funding regime might then be accompanied by a new regulatory regime focussed on price regulation and consumer protection. Such a regime could police the accumulation and use of unused surpluses, similar to regulatory processes in the utility sector. However there are real issues to be addressed associated with independence and charitable status which have been central to the sector.

Emerging shape of the sector and its changing role

If we assume that the current rents regime is here to stay and that other aspects of the government’s newly announced policy actually operate as expected, it suggests that, based on stock turnover rates (outlined on page 18 above) and predicted new build completions, affordable housing might constitute around 25 - 35% of the total stock over the next few years. The uncertainties around this figure include the continuing role of S106; the extent to which government moves to support low cost home ownership to meet their objectives of assisting first time buyers; the use made of public land (eg to support private renting); the importance of demolitions and change of use; the net impact of an improved Right to Buy offer and the appetite from local authorities to come back into new build – and the private sector's appetite to develop market housing. Probably the best guess is that social landlords will continue to provide around 17 – 18% of the total housing stock, including a significant AR component. Additional government initiatives for instance to 'privatise' elements of the HA stock through the revitalisation of the preserved Right to Buy and the introduction of private suppliers would reduce this proportion. The new RTB proposals espouse a 1 for 1 replacement policy but there is little to suggest this is as real as might be claimed –it assumes an affordable rent unit and additional resources to achieve it.

The sector has an appetite to do more. But with reduced grant, a somewhat limited one size fits all policy framework and uncertainty as to how much additional resource can be levered in from the private sector, capacity to achieve the levels of output needed will be restricted. There needs to be a proper debate as to the scale of housing requirements, the capacity to meet them and the role of the different sectors. This should have been set out in the government's Housing Strategy but the opportunity was missed. In our view some of the elements for new capacity do exist and more can be brought to bear. This would be a combination of new local authority resources, some increased borrowing on the back of the AR regime, moving forward on the grant/debt/equity agenda and bringing in private investors through a social housing REIT programme. There is real urgency about this if we are to avoid further deepening what is already a a major housing crisis.

This takes us to the second important issue - who will the sector house? The assumption in the government's impact assessment is that the sector will continue to house the same group of households that are currently accommodated. However, taking into account rent paying capacity and affordability of higher rents, the incentives for housing associations to move upmarket into the lower levels of the squeezed middle must be very considerable – and there will be plenty of demand within this group in most parts of the country.

Equally to match size of unit to size of household will involve some adjustment in who is housed. Those with existing stock with a relatively high proportion of family homes will find it harder to accommodate one person households and couples without children. Associations may look to build and acquire smaller units – or to partner with the private sector. However the strongest demand will continue to be to increase the number of new family homes needed to accommodate large households.

The area of greatest difficulty relates to the shift from supply to demand side subsidies and the impact of changes in the general welfare system. It is possible to regard the Government's Housing Strategy as a limited shift back to supply subsidies (at least into the medium term) as part of the continuing economic stimulus package.

As important is how long and the extent to which DWP will be prepared to support the increased costs of housing support arising from AR at the same time as unemployment and other demands for welfare are rising? The Universal Credit cap looks particularly difficult because of the extent to which it impacts on larger social tenant households, especially in areas where rents are high. Equally the adverse impacts on disabled and those in need of additional support have yet to be addressed. There will probably be some move towards greater support for those defined as vulnerable. Similarly the effect of Rents Direct may be dampened by additional rules, for example on reverting to direct payments to landlords for those on persistent arrears.

A particularly important issue is how the relationship between LHA and HB in the social sector will work. This interplay could significantly restrict the sector's capacity to increase rents and support new borrowing. But in the main, unless there are significant changes to the statutory duties of local housing authorities to prioritise homeless people and others in priority housing need, associations will be doing much the same job in 2020 as they do now with respect to conventional social housing while at the same time expanding their offer to help more lower paid, working households through other products.

Private sector involvement, either directly or through equity finance, is the option being encouraged in many European countries where resources are tight. International experience suggests that licensing private landlords can work in clearly defined and stable regulatory and subsidy regimes. Partnership between private providers and associations which have a long history of effective management and a strong asset base would seem to be one way forward.

Conclusion

There is no easy and immediate solution to the funding constraints that exist. There is some real capacity– the new borrowing power of some local authorities; the increased cashflows generated by AR regime; the possibility of using public land; and the potential for introducing equity and then opening up an investor market and the possibilities that the IFRA accounting standard could provide for some providers. Taken together these could generate a capacity to fund a very significant development programme, perhaps in excess of that achieved under the grant regime - although it might be more focused in high demand, higher value areas and hence less geographically spread. If it were built in part through partnerships with local authorities, builders and investors, risks could be shared and capacity increased. Far from being a one-off there is the potential here to build a long run sustainable increase in output.

The probability is that opportunities will develop slowly so we face the tension between the run-down of the grant regime and the rise of an alternative regime. Significant undersupply is thus likely to continue to characterise the market into the medium term which, while undesirable, underpins values and rates of return. This might prompt other providers to enter the market and associations could consider how they will respond and partner with new entrants. In our view this could generate opportunities that might allow the level of activity to rise more sharply. Moreover given there is little prospect of a resurgent home ownership market in the short to medium term demand is clearly being diverted into the rented sectors and affordable home ownership initiatives. In that sense housing associations have set of real market opportunities across the market with the potential for higher returns and in the context of reduced market risk.

Here the politics and economics of housing collide – the government is overseeing a decline in home ownership while championing support for first time buyers. It is also reducing social housing at a time when incomes and benefits are being reduced. Choice is being diminished and households are making some difficult decisions. There is an urgent need for a clear housing assessment that sets out likely volumes of new homes needed by tenure over the next decade and how this will impact upon overall housing supply and the demand and the balance between tenures. Only then can we have any confidence in the loose housing strategy currently in place.

Going forward

> Associations are facing a considerable challenge about the role they play in the housing market and how it might be funded. This debate is being conducted against a backcloth of policy silences and ideologically driven experimentation with a modest evidence base. Associations are being encouraged to develop affordable housing for rent and to widen the base of households they assist despite continued uncertainty as to the capacity of HB to take the strain. It is also unclear as to the scale of cross subsidy this might generate to underwrite continued development of genuine social housing. Policy is forcing a series of compromises with uncertain outcomes for residents and associations.
>
> Given the uncertain impact and sustainability of the new affordable rent regime an exploration of other funding mechanisms is urgently called for. There are a number of promising avenues though none may prove to be as effective as the previous mixed funded regime. It is also unclear as to whether a switch to rely primarily on demand side subsidies is the right way forward.
>
> The section closes with a short list of areas where we argue action must be taken quickly to underpin policy development. We re-iterate the need for a diverse policy framework which can reflect the real diversity of associations and funding capacities, their local markets and the spectrum of residents and communities. We also argue for the need to encourage innovation and to reconcile the tensions between central and local government as to the shape and direction of housing policy as expressed locally. Above all we stress the urgency of taking forward this agenda now so that housing becomes a stimulus to the economy rather than a brake on recovery.

Introduction

The whole shape and role of the sector is now being challenged in quite fundamental ways. Associations will have to make some difficult decisions about the future and where they position themselves in terms of the spectrum of the housing market and housing provision. It is not yet clear whether this future will produce a move forward, in terms of supply, efficiency and choice, or whether it will produce a move backward, to a housing market providing less protection for households unable to afford an adequate standard of housing at market, or near market, prices.

It is quite clear supply is failing to keep pace with demand and though the government has expressed a desire to see increased supply and has taken steps to encourage more homes to be built it has been silent on the overall scale of need and the role to be played by individual sectors. There has been a reluctance to do this partly because it is seen as running against an agenda about localism and the role of local authorities. However this does mean DCLG has nothing to benchmark the new supply achieved in each local authority area against and no means for arguing with HM Treasury about programme funding needs. This is a serious deficiency with enormous consequences.

It also raises the question of whether demand side subsidies are capable of producing the desired outcomes in terms of the number of homes to be produced and bringing costs into line with household incomes. Given the planned cuts in HB and the planned move to CPI rather than RPI uprating, there will clearly be real pressure on some household budgets. At the same time, with the widening of the spectrum of households who might secure homes to rent from associations, not all will be impacted by benefit cuts in the same way.

There may also be a view that the private rented sector can grow and develop as an alternative. It is clear from the HB data that it is providing homes for those with lower incomes. The sector has grown significantly and recent projections by CCHPR suggest it will grow even more rapidly if social housing output is constrained (CCHPR, 2012). However although the PRS might be a destination of choice for some it is far from clear it meets the needs of all types of households and not least families for whom some stability of occupancy is an essential requirement.

The Direction of Travel

We have argued in this report that there is a clear direction of travel in terms of the housing market and provision in England and implicitly the rest of the UK, regardless of the apparent unwillingness of the government to spell it out. In this report we have highlighted a number of dimensions including;

First, there is blurring of the boundaries and terminology around social housing and affordable housing. Affordable housing is presented as a component of social housing, but is very different. A new affordable rent regime is coming into place which is unaffordable to many and which over time will probably dominate, perhaps as soon as 2020. The impact on rents may be less than some initially thought but it will impact on lower income households and result in a wider spectrum of households coming into the sector. In our view the funding and supply options emerging are too narrowly drawn for the spread and number of households who will be looking to the social and affordable housing sector for their homes.

Second, this new dynamic poses real challenges to associations in terms of their core role. Some may choose to refocus on affordable rent markets and reduce their engagement in traditional social housing (KPMG, 2011). For some who wish to develop there may be little choice. Others will remain committed to traditional social housing, but with less capacity to develop. This also has a particular resonance in less buoyant markets and not least regeneration areas. Associations have been very active in these areas as both developers and through housing improvement and neighbourhood revitalisation. The new regime is much less likely to be capable of supporting this work and with the closure of the housing market renewal area programme along with the much reduced follow on funding it will force associations operating in these areas to consider their options.

Third, how this develops in terms of where and how people are housed will depend a great deal on the housing benefit regime and universal credit. It is unclear whether DWP will want or be able to underwrite social and affordable housing provision. DWP is under pressure to cut its own spending and has already moved to constrain the bill and to force households to make adjustments in their housing requirements and living standards. The 2012 Budget speech has strongly suggested that further reforms are likely in the future. The likely consequence of these budget cuts is that more costs will be generated in other areas.

Fourth, modifying access to social housing will constrain the inflow of those on the lowest incomes and increase the outflow of the better off. How this will work out will depend upon how these play out alongside the new focus on housing ‘deserving’ longer term local residents. A focus on working households may reduce poverty concentrations (depending on where the poor end up living as a result) but it will depend upon how attractive the offer is to incoming households who may have other choices in the open market.

Fifth, as we have argued earlier there is a risk that changes in incomes and employment along with the reductions in benefits will mean that tenants will not have the buying power to support higher rents/higher profits and thus ensure that associations generate cross subsidy. This has major implications for the sustainability of the AR regime and might suggest that the search for extra income will prove to be elusive.

Sixth, at present we assume AR will help borrowing power, although it will be some time before it will become clear how far this will really help to gear up funding. Lenders will naturally be cautious with respect to funding and there are parts of England where social rents are close to AR and thus additional borrowing power will be limited.

Seventh, where else can associations go for funding? There are a number of options although at this stage their scale and access to them is unclear. These include:

- **Partnerships with developers, funders and new private sector registered providers**: This has considerable potential and could take off relatively quickly once models emerge in the market place. Associations have the capacity to offer rent guarantees and other mechanisms to support and speed the process which could also be linked to a variety of emerging company requirements. For example, the Build now Pay later scheme for developers is one of the stronger options in the short to medium term and a number will come to market in 2012 offering an immediate way forward albeit mainly around market renting. We have also the example of Derwent Living's 2011 deal with Aviva Investors who are providing £45 million of funding to transfer of 839 properties from Home Group. This funding is part of their Return Enhancing and Liability Matching (REaLM) strategy aimed at addressing the current underfunding issue being experienced by UK pension schemes by hedging against inflation risks and generating returns in excess of liabilities. The question here is scale and speed to market and likely impact. The recent downturn in the commercial property market might help. It is hard at this stage to estimate aggregate impact in terms of schemes, profits and funding potential for affordable housing.

  The opportunity also exists for stronger partnerships with local authorities recognising that self-financing will give some authorities extra capacity and this linked with local enterprise partnerships (LEPS) and the linked Enterprise Zone regime as well as additional resources from the New Homes Bonus might suggest local authorities will have a bigger capacity for funding and that partnership where this can be leveraged to secure even greater sums will be attractive.

  There are a myriad of other smaller possibilities. What is striking about all of this is how funding through the direct grant/mixed funding regime is so much simpler and more effective. The increasing complexity of funding has the danger that ever higher proportions are drained away in overhead costs, adviser fees and VAT rather than investment. The HCA needs to engage fully with the emerging funding regimes.

- **Disposals of stock and other assets**: this has never been strongly favoured but with a new emphasis upon value for money and efficiency there is potential for associations to sell assets/create new partnerships using their significant asset base. This will be geographically concentrated and likely to be slow in terms of contributing new resources. Voluntary disposals including sales to tenants on similar terms to right to buy is one possible area for some associations. Sale and leaseback should also be considered as an alternative to full disposal and this might give some associations an increase in short term capacity alongside long term planning.

- **REITs**: the proposed REIT changes and the possibility of a social housing REIT are important new additions to the armoury, providing tax advantages and creating structures that might attract institutional investment. Both the REIT and the social housing REIT regimes do have potential and are probably seen by some in government as the real successor to the mixed funded regime. However, given the entry price, the complexity of the processes required to introduce them and the pace with which they might develop, they are a medium term addition.

- **Grant to equity**: This has clear traction as an approach which could be adopted by some providers as part of a pluralistic approach aimed at encouraging innovation. This would not work for everyone and may or may not provide part of the new funding solution. It needs to be developed and tested as a viable proposition in terms of cost of funds, impact upon rents and appetite from government to support it. This will probably evolve slowly although we would argue there is some considerable urgency in moving forward on this, at least in terms of clarifying the practicalities, eg, what is the true status of grant? In opening up this debate we also open up the wider question of equity investment in housing associations and the limitations that may be brought by the charitable status on many associations.

- **PFI**: has been useful but it has been an expensive and limited option and is probably discredited. It may be re-introduced in a different format (and with a different name) but it is hard at this stage to gauge likely impact.

- **Tax increment financing (TIF)**: local authorities will be given powers to use TIF along with new borrowing powers and in the Budget the Chancellor announced a small TIF pilot scheme of £150m available from 2013-14 to finance city projects. The infrastructure fund may help ensure local authorities support more housing development but their budgets will remain under pressure which will limit what they might do in housing terms. Here associations might help shift the balance by offering to help stretch the budget available. This will evolve slowly.

If the wider economic benefits of housing are not recognised there is a risk that public investment could fall still further with virtually no direct public subsidy for new affordable housing. In this case, associations must exploit their very obvious advantages which include:

- Strong stable organisations with significant assets and near certain cashflows
- Government backing in terms of regulation, housing benefit and past grant
- An established track record in terms of private finance and debt servicing
- Strong management and development skills
- Established relationships with local authorities and other partners

Clearly the sector can and should do more based on the advantages it already has. It needs to improve its commercial approach and to match this in terms of governance. It has to be better at understanding competition and markets: a process which is already underway. Associations have been used to being followers of markets rather than market leaders, in a world in which government has been the core driver. However, with the government now choosing to stand back, the sector must step up.

Our view is there is a real opportunity for associations in the future. There are questions about how that might take place given the diversity of the sector. It suggests that larger associations have a key leadership role.

The question then is where? The evidence in this report is that we have a serious and continuing housing crisis. We are witnessing a housing system in transition to a somewhat unclear end point – different from the past but precisely how the bits will fit together and the resultant consequences are by no means clear. On the face of it there would seem to be some very serious distributional impacts with real pressure on poorer people and a considerable erosion of hopes and expectations for quite a large section of the low and middle income population. Associations do not own this set of problems and there is, as yet, little evidence that government sees them as a priority but associations could clearly be a major contributor to overcoming them.

Policy Directions

The sector has an appetite to do more. But with reduced grant, a limited, one size fits all, policy framework and uncertainty as to how much additional resource can be levered in from the private sector, capacity to achieve the levels of output needed will be restricted. There needs to be a proper debate as to the scale of housing requirements, the capacity to meet them, the costs involved and the role of the different sectors. In our view some of the elements for new capacity do exist and more can be brought to bear. This would be a combination of new local authority resources, some increased borrowing on the back of the AR regime, moving forward on the grant/debt/equity agenda and bringing in private investors through a social housing REIT programme. Almost inevitably this means higher rents.

In this chapter we have argued that the mixed funded regime continues to have considerable merit as a structure. It has levered in significant private finance (over £60bn) and helped keep rents affordable. It is intelligible and supported by investors, landlords and others. However, beyond this regime there are potential new avenues for funding outside of government which can be exploited if policy develops further to underpin any new regime. It is also clear that if we are to have genuinely affordable rents for the full spectrum of the population then subsidies will be needed in one form or another.

There must be an open and transparent debate on the forward capacity of the Affordable Rent regime and on the tensions between welfare reform, household incomes and the capacity to pay higher rents. The diversity of the new markets under this regime and the spread of households that might be involved means that different levels and types of subsidy will be required.

The starting point for a new sustainable regime is that there must be diversity in (a) funding sources –debt, equity, grant, cross subsidy and (b) locations and markets so that the structures in place will reflect market circumstances of the localities in question. This implies policy which is a menu of options rather than a top down prescription. The government has to move forward now both to sustain these channels and to open up those still missing.

Within this we would argue the importance of retaining Section 106 obligations regarding social and affordable housing as an important creator/driver of cross subsidy. Even in the context of CIL, it must remain a realistic route likely to generate significant additional outputs. It helps ensure that land is available as well as finance – and encourages mixed communities. The realities of continuing subsidy from 106 for housing purposes is far from clear given the new emphasis on CIL

Although the issue of the conversion of past grant to equity in order to increase borrowing power has been aired for some years it now needs to be properly evaluated and tested more thoroughly as a potential way forward. We need to clarify when, where and if it will work as part of the suite of funding options available for associations. It opens up a range of other issues around mixing private and public equity and bringing new investors to this market. It is too important as a way forward to be so little developed at this time.

This also flows through into the current moves to reform the REIT regime and the potential to create a 'Social Housing' REIT through which private investors could put funds into housing association developments and secure revenue returns. If this is to be developed to suit both affordable and social housing, the REIT will require careful structuring – including allowing a mix of properties/tenures in the REIT so that some uplift in value can be captured to support funding and allowing trading to take place. HM Treasury's work in this area needs to be taken forward with urgency if a regime is to be in place in the post 2015 regime.

If social housing organisations are to be major contributors across the whole of England then it will be important that alongside specific housing programmes the wider growth fund agenda recognises and supports housing contributions as well as jobs and services. It needs to be structured to work in regeneration areas and to bring housing associations, local authorities and the private sector together.

This also suggests that we need urgently to re-engage with the debate on **housing and the economy** and to bring this up to date with an emphasis on additionality in an under-employed economy as well as effects on competitiveness. The rumoured new programme of infrastructure funding likely to be announced in the Autumn statement will include housing but the question will be how quickly these programmes can be brought to bear and impact upon the economy.

The continued lack of housing output is a further factor contributing to the volatility of the UK housing market and all the impacts this has on households, firms and the wider economy (JRF, 2011). This volatility has consequences for the home ownership and rental markets with demand pressures rising and falling through the cycle and triggering a wide array of undesirable consequences, eg, payment arrears, evictions and repossessions, negative equity and loss of confidence. The debate on housing and the economy is thus not just about jobs but also about growth and sustainability.

We also need to see a renewed debate around definitions of public expenditure and the case for bringing the UK into line with international standards. This would ease borrowing constraints around the public sector. Given that the policy stance of the government is to align activity in the UK with the market, eg, market rents and institutional finance and that the players in these markets operate across countries and in line with those wider EU standards. The government's new build indemnity scheme and local authority debt restructuring both bring the current definition into question (Wilcox, 2012) and highlight the opportunities that are being missed.

Within the rented sector as a whole, there is a need to acknowledge the importance of a mix of arrangements regarding security of tenure. More needs to be done not only to incentivise mobility but also to ensure that those who need the security are given it through social housing or long-term leases in the PRS.

With respect to the proposals on the Right to Buy, the government has now clarified that the proposals do not apply to charitable associations but it will apply to others. The government also needs to be clear about the realities of the 1 for 1 replacement and how this might differ between areas. Yet, in this new mixed economy of housing, we need to return again to the question of greater flexibility of tenure - opening up the possibility for social tenants to become owners. It was never very successful under the Rent to Mortgage scheme (which was withdrawn a few years ago) or Social Homebuy, but with AR it may be more financially attractive for tenants. There is a case for re-thinking how this might be done in terms of powers and incentives.

There is an agenda here around localities, flexibility and plurality. With partnerships between government, associations, local authorities, the private sector and institutional finance, the foundations of a new flexible regime now need to be put in place to ensure that a decent home for all remains the achievable goal of all those involved in the provision of affordable housing. But in repeating the laudable goal of successive governments it must be viewed within the context of the new realities around securing economic growth. Increased housing supply is a very efficient way of generating economic growth – it has significantly higher economic and social benefits than many other forms of expenditure. So to re-iterate the primary arguments about housing investment are economic but such investment will also increase the production of homes and through that meet household requirements, restore consumer demand and reduce social and political tensions.

What flows from this is a number of policy work streams which need to be taken forward by government and the sector with urgency. These are:

- A proper independent assessment of the Affordable Rent regime and its longer term capacity to produce homes and cross subsidy
- A speedy response to the consultation on the social housing REIT regime with a view to bringing this forward for adoption in 2013/14.
- A comprehensive assessment of the status of grant and the potential for converting it into equity with proposals brought forward to the 2013 Budget
- An early resolution of the informal consultation on PFI
- An exploration of the government's powers to offer loan guarantees as a mechanism to assist funding the affordable housing sector in the light of the precedents established through the newly created NewBuy and SME loan guarantee schemes
- A detailed assessment of housing requirements reported by local authorities in England and how these might be met through different funding streams

In all of this it is clear within the social housing sector there is an appetite to take forward new ideas. The government needs help in providing more homes for without a substantial increase in output England faces an ever more serious housing crisis which in turn will significantly hinder economic recovery. The housing association sector has shown itself to be a willing provider with the resources and capacity to take on the challenge. It is clearly a time for action, not more words.

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Facing the Future

Annexes to Final Report

Annex 1: Demand versus supply subsidy relative costs: a London example - Alex Fenton and Christine Whitehead

Method

A comparison is sought between the public costs of providing affordable housing in London by subsidy to construction of dwelling and by subsidy to rent in the private sector. Four example households are considered, all low-waged households with an adult in employment, but with varying composition: a single person, a childless couple, a lone parent with one dependent child, and a couple with two older dependent children requiring separate bedrooms. Two example boroughs are considered: Hackney and Croydon.

To calculate the cost of the supply-side subsidy, figures provided by the GLA on the subsidy per person of newly provided social rented dwellings in London is used; it is slightly over £20,000. A figure by dwelling unit by bedrooms would be preferable, but is not available.

The eligible rent on this dwelling is assumed to be under the new 'affordable' rents regime being introduced by the HCA. It is fixed at 80% of lower-quartile gross market rents (published by the GLA, derived from VOA data) less average RSL service charges in that borough in 2010 (published by the TSA). Lower quartile market rents are used to reflect the typically lower-value dwelling characteristics and location of the social rented dwelling stock. Note that the 'affordable' rents derived in this way are very considerably higher than actual current social rents. Using higher 'affordable' rents reduces the calculated cost of demand-side subsidy in the PRS, as explained below.

The demand-side subsidy cost is derived by first working out the minimum income that the household would require to afford the subsidised social rented dwelling without any Housing Benefit. Housing Benefit is paid on the whole eligible rent, less 65% of the amount by which the household's net income exceeds its personal allowance (the “Applicable Amount”) in 2010/11 (£67.50 per week for a single person aged over 25, and so on).

The household earning this amount is then assumed to be renting in the private rented sector at the maximum HB (Local Housing Allowance in the PRS) payable in that borough (since April 2011, the 30th percentile of local rents). The maximum is used as there is evidence [*can look up the parliamentary question where this came from*] that a large proportion of LHA claimants rented at or above the maximum LHA, even when it was set at the median of local rents.

The weekly LHA amount for which the household is eligible can then be worked out, as described above, given the higher rents in the PRS. This is multiplied to give an annual figure, which is then summed over 30 years applying a discount rate of 4% or 3.5% per annum. It is an open question whether there will be long-term real rent inflation relative to general price inflation which would further increase the cost of demand-side subsidy.

Conclusions

This example shows that whether demand or supply subsidies are more cost effective depends (unsurprisingly) on the relative rents in the social and the private sectors – but that reasonable differences change the answer. The discount rate makes very little difference to the calculations – and do not generally modify relativities.

Results

Hackney / Inner East London BRMA

1.1.1 Affordable Rents @ 80% of Market; Discount Rate 4%

Household	Single person aged 25+	Couple aged 18+	Lone parent and one dependent child	Couple with two older opposite sex children
Cost of build subsidy	£20,200	£40,400	£40,400	£80,800
Cost of HB rent in PRS	£67,144	£67,144	£69,304	£82,995

1.1.2 Affordable Rents @ 60% of Market; Discount Rate 3.5%

Household	Single person aged 25+	Couple aged 18+	Lone parent and one dependent child	Couple with two older opposite sex children
Cost of build subsidy	£20,200	£40,400	£40,400	£80,800
Cost of HB rent in PRS	£112,646	£112,646	£126,811	£151,201

Croydon / Outer South London BRMA

1.1.3 Affordable Rents @ 80% of Market; Discount Rate 4%

Household	Single person aged 25+	Couple aged 18+	Lone parent and one dependent child	Couple with two older opposite sex children
Cost of build subsidy	£20,200	£40,400	£40,400	£80,800
Cost of HB rent in PRS	£37,631	£37,631	£48,927	£56,595

1.1.4 Affordable Rents @ 60% of Market; Discount Rate 3.5%

Household	Single person aged 25+	Couple aged 18+	Lone parent and one dependent child	Couple with two older opposite sex children
Cost of build subsidy	£20,200	£40,400	£40,400	£80,800
Cost of HB rent in PRS	£69,528	£69,528	£88,414	£103,262

Annex 2: Social housing tenants claiming Housing Benefit whilst in employment: Findings from the Labour Force Survey - Alex Fenton and Anna Clarke

This annex looks at the characteristics of social tenants who are in employment but who still need to claim Housing Benefit (HB) in order to afford their rent. Considerable attention has been paid to non-working (unemployed and economically inactive) claimants of HB. Policy instruments for that group include altering the marginal income benefits of taking employment, and advice and support for those seeking to work. There is rather less up-to-date information about those who claim HB whilst in employment because their earned income is still insufficient to meet their rent. However, the numbers and proportion of HB claimants who are in work has risen considerably in recent years. This is partly because more private tenants now claim HB, but there are also households in social housing who claim HB while working. This note draws on recent large-scale survey data to quantify their number and describe their household circumstances. Of particular interest is the nature of their work, and the constraints on their increasing their earned income and hence reducing or obviating their need to claim partial HB to afford their rent.

Summary of findings

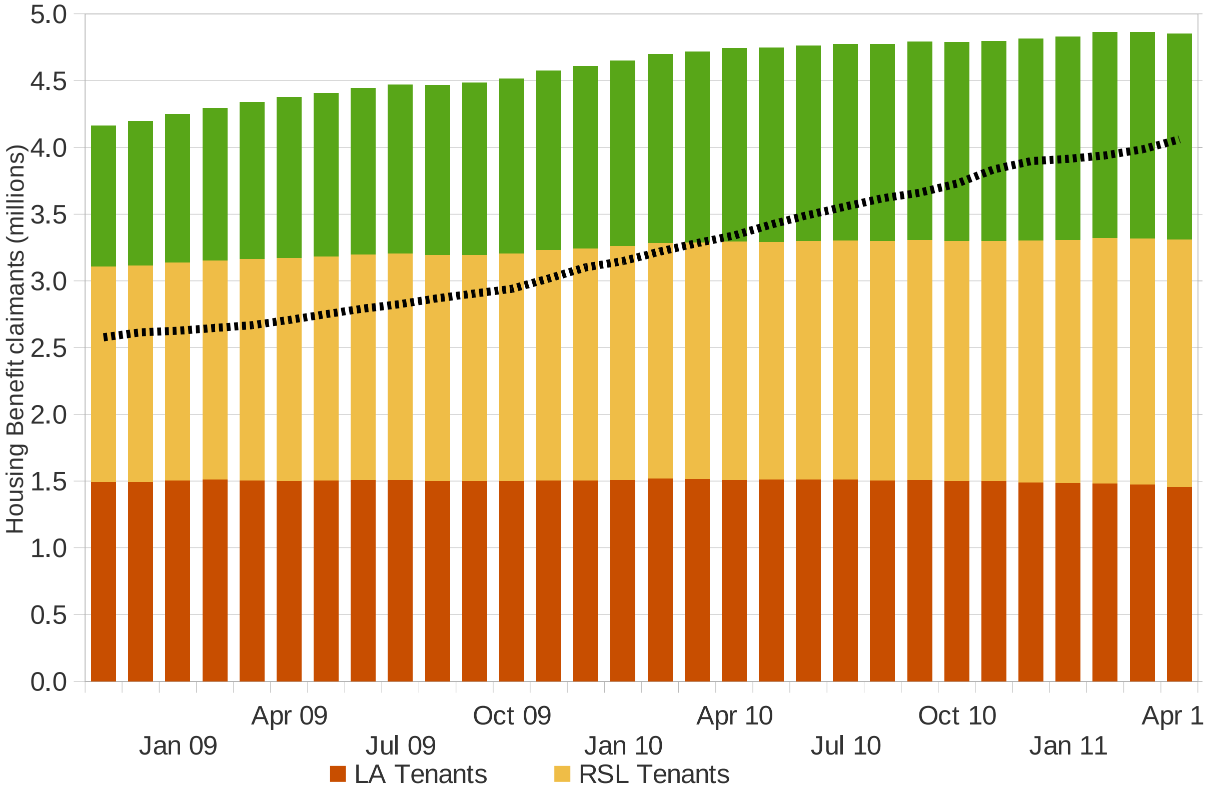
- DWP statistics on Housing Benefit show that the proportion of Housing Benefit claimants in employment (in all tenures) has risen from 10% in late 2008 to 16% in April 2011. This is likely to be primarily explained by the increasing proportion of HB claimants renting in the private sector.
- According to the Labour Force Survey, there are just under 300,000 family units living in social housing who claim HB despite the fact that there is someone in the household in employment. This is likely to considerably under-estimate the real number in the population, because benefit claims are under-reported in sample surveys.
- Survey data confirm three clear reasons that some working social tenants nonetheless require Housing Benefit: because they rely on a single income to support a family, because they work on average many fewer hours, and because they are poorly paid.
- Lone parents make up 40% of working social tenant families claiming HB, as against 20% of working families not claiming HB. Only a very small proportion of HB claimants in the social sector benefit from incomes from more than one adult. There are at least 8,000 partners of working adults who currently look after family, but would like work if available.
- Nearly half (45%) of social tenants who work and claim HB work fewer than 16 hours per week, and more than three quarters work fewer than 35 hours per week. By comparison, a majority of main working adults in family units that do not claim HB work more than 35 hours per week.
- There are at least 80,000 HB claimants in the social sector who would like to work additional hours at their current basic pay, if they were given the opportunity. This is a quarter of all employed HB claimants in social housing, and such under-employment is commoner among HB claimants than non-claimants.

- Very low rates of pay are common to the large majority of HB claimants in social housing. Three-quarters earn less than £7.38 an hour before tax and deductions. This, together with current benefit rules, limits the extent to which increasing hours might end tenants' need for HB.
- However, social tenants in general are paid much below average earnings for all workers. Differences in hours worked between non-claimants and claimants in the social sector are more marked than differences in pay.

Evidence from the DWP Claimant Statistics

The most recent release of Housing Benefit statistics from DWP covers November 2008 to April 2011. Over that period, the total number in all tenures claiming HB increased from 4.17m to 4.86m (see Figure A2.1). The statistical releases also provide sub totals of claimants who are in employment. In late 2008, 10% of all HB claimants where in employment; this rose to just over 16% by April 2011. This is a very considerable increase in a matter of a few years.

Figure A2.1: Total number of Housing Benefit claimants, by type of landlord, and percentage of all HB claimants that are in employment, November 2008 – April 2011, Great Britain



Source: DWP Housing Benefit & Council Tax Benefit statistics April 2011

The figure above also shows that during the period covered, the number of HB claimants who were LA tenants fell very slightly, whilst the numbers living with RSLs increased slightly more. However, most of the growth in claims is accounted for by the increase in private tenants claiming HB. Their numbers increased from just over 1m in late 2008 to over 1.5m in the latest data from 2011.

Unfortunately, DWP's statistical releases do not provide details of the number of HB claimants who are employed by type of landlord. It seems likely, however, that much of the overall increase in employment rates among HB claimants is accounted for by the rapid growth of HB claims made by private tenants (who are more likely to be young and economically active), and the relative decrease in the proportion of all claimants who are LA tenants (who are most likely to be of retirement age). Since the published DWP data do not provide any further information on HB claimants' employment, we have to turn, to national survey data to look more closely at employment and HB in the social sector.

Employed HB claimants in the Labour Force Survey

The Labour Force Survey (LFS) is the preferred source for analysis of employment among HB claimants in the social sector. It provides a much larger sample than the English Housing Survey (EHS) or Family Resources Survey (FRS), which have insufficient cases for analysis of this relatively uncommon category. The edition of the LFS used here provides detailed individual, family and household information on around 1,500 cases in the group of primary interest. The LFS, as the name suggests, also contains considerable additional detail about the labour market activity of each case.

The technical note at the end of this annex discusses some technical matters concerning the use of the LFS for looking at Housing Benefit. Some points should be noted before reading the findings that follow:

- The total number of HB claimants estimated from the LFS is much lower than that given by administrative data. Totals coming from the LFS are 55% to 60% of those from DWP figures. Unadjusted LFS figures are given in the tables, but real population numbers in each cell are likely to be considerably higher.
- The LFS does not accurately distinguish between tenants of local authorities and those of housing associations. Hence, the findings below relate to all social tenants.
- The LFS employs the concept of a 'family unit' which is similar, but not identical, to that of a 'benefit unit' used in welfare administration and other surveys. A benefit unit consists of an adult, their spouse or partner, if any, and any dependent children living at home. A family unit also includes any never-married non-dependent children who live at home, whereas all grown-up children are considered a separate benefit unit within a household.
- The LFS uses the common distinction between economically active adults (everyone who is employed, self-employed, or not employed but available for and seeking work) and the economically inactive (retired people, those looking after home or family, the long-term sick or disabled, most students, and others not working and not seeking work).
- Employed people are those who report receiving any payment for working, even if they work part-time or very few hours.
- Economically active people who are unemployed but who are available for and seeking work and seeking are referred to as ILO (International Labour Organisation) unemployed. They may or may not be claiming Job-Seeker's Allowance (JSA), Employment Support Allowance (ESA) or other working-age benefits.
- “Working-age adults” here refers to men aged 16 to 64 and women aged 16 to 59, inclusive.

Economic activity and Housing Benefit by region

Across Great Britain, the LFS estimates that there are just under 5.5 million working-age adults living in social housing. Of these, 2.5m (46%) are working, 2.2m (41%) are economically inactive, and the remaining 13% are ILO unemployed (Table A2.1).The regional variation is as might be expected. There is a higher proportion of employed people living in social housing in London, where housing costs are high and private housing is less affordable to working households. It is worth noting that this outweighs the effect of higher average wages in London; the paper returns to wage rates for social tenants in particular later. Scotland has the highest employment rate for social tenants; its social housing stock forms a larger proportion of the total stock, and may thus be less residualised.

Table A2.1: Economic activity of working-age adults living in social housing, Great Britain and broad regions, Q2 2010 (base: all working-age adults in social housing)

	Employed		**Unemployed**		**Inactive**		**All working-age adults**	
	000s	*%*	000s	*%*	000s	*%*	000s	*%*
North	577	*43*	179	*13*	578	*43*	1,334	*100*
Midlands	363	*45*	116	*14*	331	*41*	810	*100*
South	695	*52*	169	*13*	481	*36*	1,346	*100*
London	455	*45*	124	*12*	435	*43*	1,013	*100*
England	**2,090**	***46***	**588**	***13***	**1,825**	***41***	**4,503**	***100***
Wales	108	*39*	40	*15*	129	*46*	277	*100*
Scotland	295	*47*	93	*15*	236	*38*	624	*100*
Great Britain	**2,493**	***46***	**722**	***13***	**2,189**	***41***	**5,404**	***100***

Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010.
Note: "South" is South-East, South-West and East GORs, "Midlands" is East and West Midland GORs, "North" is North-West, North-East and Yorkshire & Humberside GORs.

Of all social tenant families where the head of the family, or their spouse, or both, are in work, 17% nonetheless claim Housing Benefit (see Table A2.2). In numbers, the LFS estimates that there are 288,000 such households; this, note, is likely to be a underestimate. There are around 360,000 adults living in social housing in a working household which requires HB to meet its rent. This is smaller than the number of unemployed adults in social housing (over 700,000), but nonetheless large enough to be of policy concern.

Again, rates of in-work HB claims are highest among social tenants in London, where over one in every five family units with someone working claims HB (Table A2.2). Again this suggests that overall higher average wage rates in London and the South do not mean that social tenants earn sufficiently more to compensate for higher rents for social housing.

Table A2.2: HB claimant numbers and proportions among family units with someone in employment, Great Britain and broad regions, Q2 2010 (base: all family units in social housing where head or partner or both are in work)

	Claiming HB		**Not Claiming HB**		**All family units with someone working**	
	000s	*%*	000s	*%*	000s	*%*
North	62	*16*	331	*84*	393	*100*
Midlands	47	*18*	210	*82*	257	*100*
South	80	*18*	374	*82*	455	*100*
London	66	*21*	247	*79*	314	*100*
England	**256**	***18***	**1,162**	***82***	**1,418**	***100***
Wales	9	*13*	64	*87*	73	*100*
Scotland	23	*12*	178	*88*	201	*100*
Great Britain	**288**	***17***	**1,404**	***83***	**1,692**	***100***

Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010.

Since the total number of underlying observations in the survey is not especially large (n=743 working-age employed social tenants claiming HB), subsequent tables and charts do not give regional breakdowns.

Sex and household composition

There are striking differences in family structure between working social tenants who receive Housing Benefit and those who do not. As shown in Table A2.3, nearly 40% of family units which partially depend on HB are lone parent households, compared to only 20% of family units which meet their rent from earned income without HB. Most, though not all, of these are households headed by women. Notably, single women in employment are also more likely to be claiming HB by comparison to their male counterparts.

Table A2.3: Type of family unit by whether claiming Housing Benefit, Q2 2010, Great Britain (base: all family units in social housing with one or both adults in employment)

	Claiming HB		**Not claiming HB**	
	000s	*%*	000s	*%*
Single male	26	*9*	237	*17*
Single female	28	*10*	162	*11*
Couple, no children	23	*8*	235	*16*
Couple with children	98	*34*	515	*36*
Lone parent	113	*39*	280	*20*
All family units	288	*100*	1,430	*100*

Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010

There are similar proportions of couples with children among working social tenant families who claim HB and those who do not. However, Table A2.4 shows that whereas a majority of two-adult families who do not claim HB have both adults in employment, only a tiny minority of couples who claim HB are both working. 30% of partial HB claims are from working families with one earner and an economically inactive partner, and a further 8% from those with an unemployed partner.

Table A2.4: Economic activity of head of family unit and partner, Q2 2010, Great Britain (base: all family units in social housing with someone in employment)

	Claiming HB		**Not claiming HB**	
	000s	%	000s	%
One employed adult only	167	58	683	48
One employed, partner unemployed	24	8	55	4
One employed, partner inactive	86	30	267	19
Two adults, both employed	11	4	425	30
All family units	288	100	1,430	100

Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010

Just over half (44,000) of economically inactive partners of working social tenants claiming HB are those looking after home or family. A slightly smaller number (31,000) are long-term sick or disabled. The remainder are students, retired people, or those not seeking work for other reasons.

One final question is the proportion of inactive partners of employed HB claimants that would like employment. The number of cases becomes quite small at this point, so some caution is needed. However, looking at the largest group of inactive partners of HB claimants, those who are looking after home and family, only just over 15% say they would like to work (around 8,000 of around 46,000 partners looking after family).

Hours and pay

The preponderance of part-time employment is central to the difference between those claiming HB while working, and those not. Nearly half of social tenants claiming HB worked fewer than 16 hours a week, compared to only 14% of those who do not (Table A2.5). Fewer than a quarter are working full-time, taken to be 35 hours or more per week, compared to more than half of those who do not claim HB.

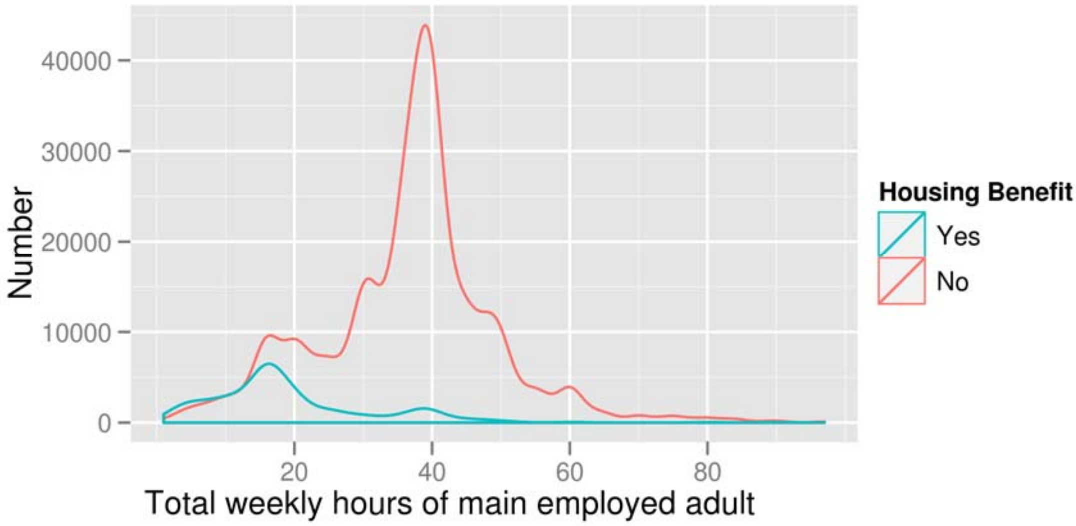
Table A2.5: Hours worked per week in all jobs, by whether claiming HB, Q2 2010, Great Britain (base: all people working > 0 hours in social housing)

	Claiming HB		**Not claiming HB**	
	000s	%	000s	%
Fewer than 16 hours	151	*45*	270	*14*
16 to 35 hours	109	*32*	631	*32*
More than 35 hours	78	*23*	1043	*54*
All working people	338	*100*	1944	*100*

Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010

We have already seen that part of the difference in circumstances between working claimants and non-claimants is that non-claimant families more commonly have multiple persons in employment. If we look only at the person within the family working the longest hours, the difference between claimants and non-claimants is even starker (Figure A2.2).

Figure A2.2: Hours worked per week by main employed adult, by whether Housing Benefit claimed (base=all adults in social housing working longest hours within family unit)



Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010

Under-employment

This raises the question of the numbers of social tenants who would like to work longer hours than they do currently. The LFS asks employed people the question "Would you prefer to work longer hours at your current basic rate of pay – that is, not overtime or enhanced pay rates – if you were given the opportunity? ". The LFS estimates that there are 80,000 working people in families claiming HB who would like to work longer hours. This is a quarter of all employed people in such families, a higher proportion than for other social tenants.

Table A2.6: Desire to work additional hours at current basic pay, by whether claiming Housing Benefit (base: all employed adults in social housing)

	Claiming HB		**Not claiming HB**	
	000s	%	000s	%
Would like additional hours	79	*24*	282	*14*
Would not like additional hours	252	*76*	1684	*86*
All employed persons	331	*100*	1966	*100*

Source: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010

Low Pay

Low pay is also a major factor in causing social tenants in employment to continue to need housing benefit. The median average gross (before tax) hourly pay of social tenants who claim HB is £6.13 (Table A2.7). 90% of employed social tenants claiming HB earn less than £9.45 an hour. Looked at another way, the median hourly pay of social tenants with HB is well within the lowest 20% of pay rates for all working people.

Table A2.7: Percentiles of gross hourly pay (£) in main job, by tenure and whether claiming Housing Benefit (base: all persons in paid employment)

	Bottom decile	**Lower quartile**	**Median**	**Upper quartile**	**Upper decile**
Social tenants claiming HB	5.00	5.67	6.13	7.38	9.45
Social tenants not claiming HB	5.00	6.00	7.50	9.85	12.89
All owner-occupiers and private tenants	5.75	7.29	10.50	16.02	22.74

Source: Labour Force Survey, Quarterly Person-based Edition Apr-Jun 2010

These low rates of pay should be taken alongside with current tax and benefit rules which specify the rate at which Housing Benefit and Council Tax Benefit are withdrawn as earned income increases (currently 65p in the pound for HB alone). It suggests that modest increases in hours are, for many social tenants, unlikely to end the need for assistance from HB to meet the rent. However, it should also be noted that differences in hours worked are much more striking than differences in pay rates when comparing claimants and non-claimants in the social rented sector.

Public and private sector

One further question of policy interest is whether social tenants who need HB whilst working are employed in the public or private sector. This bears on the extent to which HB can be seen as a subsidy to low-pay and voluntary or involuntary part-time working in private enterprises. Table A2.8 shows that 80% of people living in social housing, working and claiming HB are employed in the private sector, compared to 75% overall. This may not be unexpected, as there are more low-paid, low-skilled jobs in the private than public sector.

Table A2.8: Employment in public or private sector, social tenants claiming HB and all people, Q2 2010 Great Britain (base: all employed persons)

	Private sector		**Public sector**	
	000s	*%*	000s	*%*
Working social tenants claiming HB	1,914	*80*	466	*20*
All people in employment	21,464	*75*	7,271	*25*

Source: Labour Force Survey, Quarterly Person-based Edition Apr-Jun 2010.

Technical note

The Labour Force Survey is a long-established government survey covering a large sample on a repeated cross-sectional basis. The April to June 2010 quarterly edition has been used in this paper. The LFS is regularly released to researchers via the Economic and Social Data Service in a number of versions. The version used for the bulk of the analysis presented here is the 'household edition', which provides additional information at the household level. For some analyses, particularly of wages, the person-level edition has been used which includes variables not present in the household edition.

1: Tenure recording in the Labour Force Survey

The LFS is known to mis-record the landlord of social housing tenants. Specifically, it overcounts local authority tenants at the expense of RSL tenants. This is thought to be a consequence of former LA tenants transferred to HA landlords continuing to report their landlord as the local authority. The discrepancy is set out in Table A2.9, which compares totals derived from the LFS, for England only, to totals estimated from the English Housing Survey (EHS). The EHS, given the focus of the study, directs survey interviewers to probe carefully to ensure technically correct recording of tenure, including that of stock-transfer tenants.

Table A2.9: Comparison of total of LA and RSL tenant households in EHS and LFS, England, 2009-10

	Labour Force Survey Apr-Jun 2010 (millions)	**English Housing Survey 2009/10 (millions)**
LA tenants	2.04	1.75
RSL tenants	1.68	1.93
All social tenants	3.72	3.68

Sources: Labour Force Survey, Quarterly Household Edition Apr-Jun 2010; CLG Live Table FT1101.

We can see that although the LFS under-counts RSL tenants by comparison to the EHS, which asks in more detail about tenure, the total social sector size is very close. Therefore, all the analyses below look at all social tenants in the LFS.

2: Under-counting of benefit receipt in the LFS

Total numbers of Housing Benefit claimants which are estimated from the LFS are consistently very much lower that totals derived from administrative statistics, such as those published by DWP. This under-recording of the receipt of welfare benefits is long-standing and well-known to survey methodologists. It is not particular to Housing Benefit, nor to the Labour Force Survey, nor indeed to UK official statistics. There are numerous explanations, including respondents not remembering (which may be the case when numerous benefits are received, or when HB is paid as a rent rebate), deliberate non-reporting by respondents, mismatches in measurement periods, and the inflating effects of error and fraud on administrative statistics. A comparison between DWP administrative statistics and totals from the LFS is given in Table A2.10.

Table A2.10: Housing benefit claimant totals by tenure, from DWP administrative statistics and the Labour Force Survey, Quarter 2 2010, Great Britain

	DWP HB statistics May 2010 (thousands)	**Labour Force Survey Apr-Jun 2010 (thousands)**	**LFS as % of DWP**
Social tenants	3,294	1,830	56
Private tenants	1,455	838	58

Sources: DWP Housing Benefit and Council Tax Benefit Statistics April 2011, Labour Force Survey, Quarterly Household Edition Apr-Jun 2011.

The table shows that totals of HB claimants derived from the LFS are a little over half those that given by the administrative data published by DWP. Importantly, the degree of under-reporting likely varies between working and non-working households, since most working households will have had to take deliberate steps to secure their HB entitlement, whereas some non-working households will have been 'passported' to HB in the course of claiming other means-tested welfare benefits. One cannot therefore simply up-rate population totals from the LFS to match DWP figures when looking at employment, and unadjusted population estimates have been given in all tables. These should be read with the understanding that the real population totals are likely to be larger.

Annex 3: Mobility and work - Alex Fenton and Anna Clarke

This analysis was carried out in order to explore whether social tenants who rent from large national landlords operating in many parts of the country are more likely to make long distance moves. It is not possible to establish precisely which tenants were transferring within their landlord's stock as CORE does not record the previous landlord. It is however possible to identify tenants whose current and previous tenure was HA and those whose current and previous tenure was LA. It is likely that many of these are moving within their own landlord's stock and it is these tenants on whom this analysis focuses.

Table A3.1 shows the proportion of moves within sectors (ie HA to HA or LA to LA) that were to a new local authority district, and the proportion that were within the same district.

Table A3.1: Moves between LAs and within LAs of social tenants transferring within sectors[2]

	Number of LAs where landlord holds stock				Total
	1	2-10	11-50	Over 50	
Moved between LAs	939	828	1,182	519	3,690
	4.4%	8.6%	15.9%	17.7%	8.5%
Moved within LA	20,446	8,824	6,246	2,406	39,709
	95.6%	91.4%	84.1%	82.3%	91.5%
All moves	21,385	9,652	7,428	2,925	43,399

Sources: CORE 2009/10, RSR 2009 and National Statistics Postcode Database

As can be seen, tenants of landlords who hold stock in many areas are more likely to move between areas. Only 4.4% of tenants moving within a sector whose landlord hold stock only in one area moved between areas, but this rises to 17.7% of those whose landlord holds stock in more than 50 districts.

A similar analysis can be made by distance of move (Table A3.2)

Table A3.2: Distance moved by social tenants transferring within sectors[3]

	Number of LAs where landlord holds stock				Total
	1	2-10	11-50	Over 50	
0-4 km	9,456	3,680	2,952	1,015	17,944
	70.2%	59.2%	59.4%	57.3%	64.9%
5-9 km	2,547	1,389	1,052	368	5,584
	18.9%	22.3%	21.2%	20.8%	20.2%
10-19 km	996	766	603	229	2,689
	7.4%	12.3%	12.1%	12.9%	9.7%
20-49 km	387	319	313	112	1,161
	2.9%	5.1%	6.3%	6.3%	4.2%
Over 50 km	81	63	50	47	250
	0.6%	1.0%	1.0%	2.7%	0.9%
Total	13,467	6,217	4,970	1,771	27,628

Sources: CORE 2009/10, RSR 2009 and National Statistics Postcode Database

[2] It is not possible to establish precisely which tenants were transferring within their landlord's stock as CORE does not record the previous landlord. It is however possible to identify tenants whose current and previous tenure was HA and those whose current and previous tenure was LA. These are those who are included in this table.
[3] Distance moved is the direct distance in a straight line.

By this measure too, it can be seen that tenants of landlords active in more areas are more likely to make long distance moves.

CORE does record the reason that the move was made, including those who move for work reasons. However the numbers here are very small and no significant difference could be found between the tenants of different types of landlord in their tendency to move in order to be nearer a job.

Technical note

The data used in this annex come from the 2009/10 CORE database, the National Statistics Postcode Database and the Regulatory and Statistical Return completed by RSLs.

NSPD

The August 2010 edition of the National Statistics Postcode Database (NSPD) was used, and allows the matching of geographical/administrative identifiers from full postcodes

Details from the NSPD are matched for each CORE letting case based on the postcode of the newly let property, and also the tenant's previous address where known. All but a very small number of new postcodes are successfully matched; the old postcode is known and matched for around 75% of cases. The NSPD provides an indicator of the geographical location of each address (northing/easting) and a definitive identification of LA district and GOR.

RSR

The March 2009 edition of the RSR was employed, specifically the detailed LA breakdown of RSL stock. The RSR is used to provide indicators of the spatial extent of the letting landlord's estate. Overall, about 95% of cases can be given matched data on the spatial extent of landlord stock. In some cases, the RSL code has changed due to mergers and acquisitions, and in others, there are missing data in the RSR.

Annex 4: Local authorities: Housing Revenue Account reform and self-financing - Michael Jones

The reform of local authority Housing Revenue Account finance, introduced from 1 April 2012, has abolished the old subsidy system for council housing, and put each of the 171 local authorities which still owned housing stock at that date onto a ‘self-financing’ basis.

The former subsidy system

The former subsidy system for council housing was essentially a revenue deficit system with annual subsidy payments to cover deficits in Housing Revenue Accounts (HRA), in contrast to the ‘one off’ capital grant system used to subsidise rents in the housing association sector.

Under the former HRA housing subsidy system, the government calculated a theoretical, or notional, HRA for each local authority. This balanced the income from the formula rent system against the expenditure which the government considered necessary to manage and maintain the stock, and to service debt.

The expenditure required was calculated by the government in three separate allowances, for Management, Maintenance (day to day repairs) and the Major Repairs Allowance (for the replacement of 'end of life' building components).

If income was less than expenditure, the deficit was then made up by the government by paying positive housing subsidy. If income was more than expenditure, then the surplus was payable to the government as negative housing subsidy.

In practice, no local authority had rental income exactly at the formula rent level, or was spending at exactly the amount calculated for the allowances. A local authority with rents below the formula rent, and spending less than the allowances, had room for manoeuvre, whereas a local authority with rents then in excess of the formula, and spending more than the allowances, was under pressure to reduce expenditure at the same time that rental income was falling in real terms.

In the years immediately prior to 2012/13, the subsidy system was very roughly in balance, with the surpluses of around 140 local authorities slightly exceeding the deficits of around 30 local authorities (nearly all larger metropolitan authorities).

The new ‘self- financing’ system

The new ‘self- financing’ system has essentially redistributed sufficient of the debt of the authorities that were in deficit to the authorities that were in surplus, so that the excess of rent income over the three allowances for each of the 171 local authorities is exactly sufficient to service the redistributed debt.

If each local authority were charging rents in line with the formula, and spending in line with the increased allowances, then all surplus income in excess of the expenditure allowances would be absorbed in servicing the redistributed debt.

As a result of debt redistribution, the previous deficit subsidy system has ceased to exist. There are now no HRA deficits requiring positive subsidy, and no surpluses to be clawed back. Each local authority now has a 'self- financing' HRA, with no need for any further subsidy from central government (other than Housing Benefit).

HRA reform does not alter the requirement for housing authorities to maintain a Housing Revenue Account, which must be kept in balance. (As a result, most local authorities maintain substantial cash reserves in the HRA, often at around 5% of turnover). Local authorities remain prohibited from funding any HRA deficit from the General Fund, or from transferring any HRA surplus to the General Fund.

Prior to 2012/13, the 'national HRA' was slightly in surplus, and this was used to sweeten the pill for local authorities by slightly increasing the M&M allowances and increasing the Major Repairs Allowance (MRA) by 28%. (The BRE had prepared estimates for the previous government's HRA Review showing that MRA was then underfunded by between 28% and 90%, depending upon the extent of works included: the lower increase chosen will probably result in continuing underfunding for local authorities with high proportions of flatted and higher rise stock.)

The self- financing proposals do not make any allowance for debt repayment: as a consequence, local authorities are likely to be heavily constrained in the near future, for a number of reasons:

(a) Under the previous system, any movement in interest rates on housing debt was entirely covered by government subsidy: a reduction in interest rates resulted in less government subsidy, while any increase in interest rates resulted in more government subsidy. Under the new system, any change in interest rates has to be met directly from the HRA. (Most HRA debt is borrowed long term from the PWLB: as a result, interest rate changes are relatively slow moving in their effect.) HRA debt is in practice consolidated with other local authority debt in a single consolidated fund: for housing authorities, HRA debt is likely to be the majority of outstanding debt (and for previously debt free local authorities, their share of the redistributed national HRA debt will constitute 100% of outstanding debt). The reform poses significant risks in debt and treasury management for local authorities, and it is likely that very conservative policies will be pursued by local authority chief financial officers.

(b) Local authorities remain constrained by central government controls on total local authority borrowing, with each HRA allocated a debt ceiling. The debt ceiling is the theoretical amount of debt that can be supported by each local authority's free cash-flow, after spending at the level of the allowances. In practice, the actual HRA debt might be more or less than the theoretical maximum. Higher levels of debt are relatively unusual, while lower levels of actual debt than the calculated maximum are more frequent, and are mainly the result of past quirks in the subsidy system.

(c) 143 of the 171 local authorities with stock at 1 April 2012 have some ‘headroom’ for additional borrowing, totaling £2.8bn. However, this is highly concentrated, with 50% of the headroom concentrated in only 22 authorities, and 75% concentrated in 50 authorities. The distribution of headroom is also fairly random: among the London Boroughs, Greenwich and Harrow have no headroom, while Manchester has £60m of headroom and Birmingham has none.

(d) However, even if a local authority has 'headroom' between its share of redistributed debt and the allocated debt ceiling (or cap), there will be no free cash-flow to support additional borrowing. (Although HRAs have additional sources of income other than housing rents, such as garage or shop rents, or interest on balances, these are a very minor proportion of total income.)

(e) Local authorities can raise rents above the annual guideline rent increase (which remains in place in the new system), but any additional cost of Housing Benefit must be met from the additional rent income raised. This acts as a very strong disincentive for rent increases above guideline, and therefore constrains the ability of local authorities to increase free cash-flow.

(f) Local authorities are also likely to be constrained by changes in the accounting framework which require the depreciation of the housing stock by estimations of the remaining life of building elements (the former accounting framework maintained the convenient fiction that depreciation was exactly equal to MRA): again, this has introduced an element of uncertainty which will almost certainly have differential effects in different local authorities.

Conclusions

The overall effect of the self- financing reform of the HRA system is to cut local authorities free, or adrift, of the former subsidy system. Their position is now similar to that of housing associations, but with significantly greater constraints.

The extent to which the self- financing settlement will prove sustainable in revenue terms is as yet unknown, since the new system is based on theoretical calculations of each local authority's 'need' to spend, rather than on actual need. Local authorities which have completed Decent Homes programmes are likely to be significantly less revenue constrained than those that have not.

The redistribution of debt, and the implications of future changes in interest rates, will place much greater responsibilities for debt and treasury management on all landlord local authorities. This may well lead initially to conservative financial policies, which may also be combined with a reluctance to realise the value of assets, at least until the overall picture becomes clearer and a degree of confidence in the new arrangements develops.