NATIONAL HOUSING FEDERATION

Funding future homes:
Executive summary and discussion

business for neighbourhoods

UNIVERSITY OF CAMBRIDGE
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Cambridge Centre for Housing & Planning Research

Funding future homes
Executive summary and discussion questions

When it comes to building new homes housing associations are navigating one of the most challenging and turbulent periods in recent history. The operational environment is increasingly risky, with the stalled economic recovery and welfare reform impacting on tenants' incomes and making the funding environment uncertain.

We are building the lowest number of new homes since the 1940s and at the same time the homes and services provided by the sector are in high demand with waiting lists for affordable homes still rising.

We support the Government's ambitions to deliver 170,000 new affordable homes by 2015, and housing associations will provide 90% of these homes. The measures set out in *Laying the Foundations*, the Government's housing strategy for England, also provided a small but welcome boost to the industry (Communities and Local Government (CLG), 2011). However, these proposals fall far short of addressing the roots of our housing crisis.

Housing associations produced nearly half of all homes built in England last year (National Housing Federation, 2011). The National Housing Federation believes that now is the time to look to the future and consider the role that housing associations could play in supporting a healthy housing market. Central to this proposition is an examination of measures that could increase housing associations' contribution to new supply.

Our intention is to work with our members and stakeholders to develop a vision that will take us beyond 2015: a vision that will support the delivery of a range of high quality housing at a scale to meet the needs of local communities, offer excellent value for money to the taxpayer and be financially viable for housing associations to deliver. Our ambition is that our vision will influence the political debate and Government's thinking on future investment models.

To ensure that our vision is underpinned by robust evidence the Federation commissioned Cambridge Centre for Housing and Planning Research to produce a background evidence paper. This is an executive summary of that paper and a list of discussion questions for members to consider. The full evidence paper can be downloaded at www.housing.org.uk.

1 The housing crisis: an evidence base

The housing crisis has become so pronounced that scarcely a week goes by without comment and coverage in the national media. In the evidence base we aggregate the research and evidence on the dynamics of the UK's housing market. The evidence demonstrates that:

- Housing need and demand are so great compared to housing supply that the number of new homes we need are far in excess of what the Government can fund and the market can supply in the short to medium term – and perhaps even into the longer term. Need will remain high regardless of the wider economy and housing market.

- The key future drivers of demand for new homes will come from population and household growth, and will become more pronounced after 2015. In relation to affordable housing there will continue to be a particular demand for housing for older people and lone-parent families.

- Single households have become the biggest growth segment in recent years and this is likely to continue in the future. This group is also most affected by the financial crisis.

- The number of people in the private rented sector (PRS) is increasing, whilst numbers of families in owner-occupation and the affordable housing sector are decreasing. However, there has been little change in tenure aspirations and the majority of people would still prefer to own their own home. Growth in the PRS is largely due to economic necessity rather than choice.

- The supply of new homes has been falling for years but the financial crisis has further decimated the supply of new homes. Recently affordable housing has represented around half of all new housing supply.

Discussion questions:

1. *What is the future role of the housing association sector and our offer to government for funding future homes?*

2. *How should the sector respond to changing demographic and tenure patterns? What are the implications for the sector's future housing offer?*

2 Where we've come from – trends in government investment in affordable homes

There are a number of ways that successive governments have tried to address the problem of how we build more affordable homes. Building new homes helps boost the economy and create local jobs, but the economic and social benefits of house building are not always recognised.

This section considers the economic benefits of housing provision before turning to consider the patterns and trends in government investment in new homes. Providing new homes at a subsidised cost requires subsidy to make development viable, but the form and level of that subsidy can take many different forms. Key findings include:

- Figures vary but building new homes contributes up to 3% of GDP and the total multiplier effect of the construction industry, within which housing lies, is estimated at 2.84. This means that for every pound spent on construction, an estimated £2.84 is generated in the wider economy.

- There are clear economic benefits from investment in new homes but a stronger case could be made by considering contributions to GDP made by housing-related consumption such as repairs and maintenance, solicitors' and surveyors' services and household purchases.

- Since 1989 housing associations have built 453,000 new homes. During this time there has been a gradual decline in the amount of public investment going into each new home, with housing associations filling the subsidy gap through private finance and the use of their own resources. Predictably, trends in the number of new affordable homes rise and fall in line with levels of public investment.

This section also considers trends in how the Government, and its investment agencies, work with housing providers to deliver homes that are partially funded by the taxpayer. The main issues explored are:

- The introduction of investment partnering in 2003, has resulted in new strategic partnerships between housing providers. Whilst it has led to some efficiency benefits it has not achieved the full range of perceived benefits from partnerships.

- Value for money for government has improved but the factors behind this are not clear and are a mixture of market factors and efficiency savings. The investment agencies' approach to assessing value for money typically has focused on average grant rates and numbers of new homes.

- There have been improvements in the investment agencies' approach to programme management but the sector has consistently argued that greater freedom and flexibilities could improve the provision of new homes and value for money whilst still ensuring transparency and accountability.

- The Affordable Homes Programme (AHP) 2011–15 has led to a greater level of risk being transferred to housing providers and requires much higher levels of borrowing. There are also some concerns about the limitations of the model, for example the narrow range of housing tenures that can be offered under the model.

- The Government's recent housing strategy, *Laying the Foundations*, sets out a number of measures designed to improve the housing supply. The measures will help but will not lead to a substantial increase in new supply.

- Housing supply, and to a certain extent the shape and dynamics of the housing market, are affected by taxation and fiscal policy. As it currently stands, home ownership remains fiscally favoured despite the scrapping of mortgage interest tax relief, because of the lack of capital gains tax. The private rented sector is the least favoured, being treated as an investment good but with no depreciation allowance. There is a growing debate about housing taxation.

- Over the past 20 years the delivery of new affordable housing in England has become very dependent on support through the planning system, recently providing support worth billions of pounds a year. However the current policy context for the provision of affordable housing through the planning system is very unsettled and affordable housing supply may be reduced as a result.

Discussion questions:

3. *How can we best demonstrate the economic and social benefits of building new homes?*

4. *Does the mixed funded model remain the best mechanism for Government investment in affordable homes?*

5. *Is a partnership approach the right model for an investment programme? If not, what is?*

6. *Are there factors limiting value-for-money improvements and is there more the sector can do to improve efficiency savings?*

7. *How should the Government assess value for money?*

8. *What principles should underpin government investment in new homes?*

9. *What housing tenures should future investment programmes support? In the future should the investment agency continue to stipulate which products it will fund?*

10. *Are there ways programme management could be improved whilst ensuring appropriate transparency and scrutiny?*

11 *What are the main challenges of the AHP and how could future investment models address them? How could future investment models work better for smaller housing providers?*

12 *Are changes to taxation and fiscal policy needed to help support the provision of new homes and if so what are they?*

13 *How should the planning system, and planning reform, support the delivery of affordable housing?*

3 Investment challenges

There are a number of fundamental challenges to ensuring that investment models are able to deliver a range of different housing options in different housing markets to meet local need. This section considers some of the challenges of managing investment in new homes and ensuring the best possible outcomes. Areas for discussion include:

- The challenge of finding a model that works across low and high value areas and different housing markets. The variations pose real challenges for housing associations. They impact upon the cost of land and other acquisition costs and upon the value of the assets that housing associations hold.

- Housing associations have been active providers of specialist housing both for the elderly and for those requiring special adaptations. Management is expensive and overall payments have to take into account additional services provided. The viability of this type of provision depends as much on Supporting People payments as on rent support and is vulnerable with the cuts to Supporting People funding. To get off the ground, viable development projects tend to require higher per unit grant rates than general-needs housing, a complex mix of capital and revenue funding and commitments from a range of partners and commissioners.

- There is a strong need for more homes in rural communities, which in turn would help unlock increased economic contributions. There are specific challenges for rural housing provision, particularly relating to land availability and higher development costs on some schemes.

- Larger units account for less than 0.5% of stock and there is relatively little new supply of larger homes across all tenures. New supply may be further limited due to changes in welfare reform, and the impact on families' ability to pay their rent.

- Cuts in public funding for regeneration, combined with the difficult economy, are threatening to undermine many regeneration initiatives.

Discussion questions:

14 *How should Government investment in housing be targeted?*

15 *How can future investment programmes best support the delivery of specialist and supported housing?*

16 *How can future investment programmes best support the delivery of rural homes?*

17 *How can future investment programmes best support the delivery of larger homes?*

18 *How can future investment programmes best support regeneration?*

19 *How can we drive forward regeneration in the context of drastic cuts to public investment for regeneration?*

4 Meeting wider housing need

Previous sections discussed recent demographic changes and their effect on housing tenure, as well as changes of emphasis from government on what kinds of tenure will receive public subsidy. One effect of the changing nature of our housing market is to open up the question of how we meet wider housing need. Housing associations are increasingly working to offer housing solutions for the intermediate market though shared ownership, shared equity and private rented schemes. This section considers:

- Trends in the supply and demand for intermediate housing options. In 2010/11 21,460 new affordable homes were in the form of shared ownership and shared equity, a fall of 13% since 2009/10. Previously the total had increased steadily since 200/01 (CLG, October 2011).

- Estimating level of demand is difficult but housing associations have over 137,000 live applications for intermediate housing and in 2010/11 alone received nearly 76,000 applications (Homes and Communities Agency (HCA), 2011). Supply under the AHP will not be enough to meet demand.

- How intermediate models could be used to help meet the housing needs of older people.

- Housing associations are increasing involved in providing private rented sector and market housing. This helps meet wider housing need and provides cross-subsidy to support the development of social rented homes and neighbourhood activities.

Discussion questions:

20 *Do we have the right range of intermediate products? If not, what other products should the sector offer?*

21 *What intermediate housing options should be funded with government support?*

22 *Can we do more to increase the number of intermediate homes without public subsidy?*

23 *How can we increase the supply of intermediate housing options to meet need and demand?*

24 *Can we expand the intermediate housing offer to meet the housing needs of older people?*

25 *What role is there for housing associations in the private rented sector, and what, if any, barriers are there to undertaking that role?*

26 *What is the potential for the increased provision of market housing as part of the sector's investment offer?*

5 Financial capacity and rent

Crucial in shaping the debate on housing associations' role and potential in meeting housing need is the financial health and capacity of the sector. This section looks at the financial strength of the sector and the factors that will impact on its ability to raise the finance required to build new homes.

- The sector's turnover continues to increase, and margins improve leading to increased surpluses. This trend allows housing associations to respond to ongoing challenges in the operating environment ensures their continued financial robustness and ability to respond positively to an era when they are absorbing more risks.

- As grants dwindle, the balance between private finance and rental income is changing. 93% of housing associations current financing facilities are due for repayment in the next five years. In an uncertain era, the sector will be exposed to more financing risk than ever before. It will need to source significant additional amounts of funding as well as to identify opportunities to cross-subsidise housing associations' development activity.

- Welfare reform and the introduction of Universal Credit is a potential threat to the stability of rental income, which may involve increased costs for many organisations if they are to be mitigated successfully. The impact of the Affordable Rent regime and the potential to charge rents at up to 80% of the market rate to make up the shortfall in grant income is also unclear. There is also a question about the long term sustainability of the Affordable Rent regime. Without significant levels of capital grant, higher levels of borrowing mean that some housing associations may reach their borrowing limits and be unable to fund the development of new homes in the future.

Discussion questions:

27 *Would an investment model similar to the affordable rent regime be sustainable beyond 2015?*

28 *What are your views on a revenue versus a capital investment model?*

29 *Should housing associations have freedom over what rents they charge or should they continue to be set by the Government?*

30 *How can we ensure the future financial viability of housing associations?*

31 *Are there steps that can be taken at sector level to help to open up and/or secure future sources of finance?*

6 Funding Future homes: an assessment of alternative development and funding models

In the context of decreasing grant levels and challenging financial markets it is important that we consider the potential of funding and development models that could help increase the supply of new homes in the future.

This section categorises six types of funding models: government grant, tax and planning gain funds, guarantees to lower the cost of funds, restructuring payments, equity models and increased access to different debt funding sources.

The section considers the strengths and weaknesses of different models. A tabular summary of the evaluation of different models is presented (see below) (a detailed discussion is given in the Appendix). Some of the issues with the models identified are:

- There are strengths and weaknesses with all the models. Several are entirely dependent on government funding and may not be sustainable into the longer term. Others are tightly linked to the housing market and the viability of private development, whereas government-funded mechanisms can act counter-cyclically. Some are so new that they have not been tried and tested. Models that aim to share risks between the public and private sectors can often be cumbersome, complex and inflexible, but they are worth exploring further.

- The traditional mixed funding / cross subsidy approaches have worked well in the past and have been capable of allowing flexibility when external circumstances change.

- All of the models present different potential issues for housing associations, depending on the organisation's profile and aims, and some challenges to the sector as a whole. Whilst there is capacity to undertake large-scale development if the conditions are right, most of the larger-scale ways of raising additional finance involve the transfer of stock from traditional social housing to at least intermediate rents and in some cases market rents.

Discussion questions:

32 *What is the potential of alternative development and funding models to help support the delivery of new homes?*

33 *What barriers are there to these models that need to be addressed?*

34 *Are there other potential models that we should consider?*

Possible funding models for affordable housing

Model	Source of funds	Essence of the model	Strengths	Weaknesses
Government				
New Homes Bonus (NHB)	Grant from government	Local authorities in England receive grants that match the council tax raised on increases in effective stock (new built + empty properties back into use) for the following six years.	Increasing housing stock; stimulate competition between local authorities.	NHB payment insufficient to induce change in attitudes to new development.
Revolving land bank funds (RLBFs)	Grant from government	Local authorities establish LBFs to acquire sites and put the necessary infrastructure in place to enable housing development. Revenues raised from the sale of sites, and any developer contributions, pay back into the fund, facilitating further investment and development.	Timing to establish RLBF crucial as markets are cyclical, land values can inflate rapidly in property boom.	Values of LBF heavily influenced by performance of land and property market.
Loan guarantees	Central/local government	A promise by Government to assume the debt obligation of housing associations/ local authorities if housing association /local authority defaults.	Lower borrowing costs.	May be biased towards large and financially strong housing associations.
Developers/ landowners				
Section 106	Developers	Local planning authority enters into a legally binding agreement with a landowner/private housing developer to deliver affordable housing in addition to the provision of associated services and infrastructure.	Delivered locally and hypothecated on affordable housing and associated costs.	Linked to performance of land and property market. After 6 April 2014, cannot pool more than five s106 payments for infrastructure.
Community Infrastructure Levy (CIL)	Developers	Local authority levies a charge on new developments (not just housing) to provide infrastructure to support the development of an area.	Can apply to all new development, even small schemes.	Similar to S106, depending on viability of market development.

Model	Source of funds	Essence of the model	Strengths	Weaknesses
Fiscal incentives				
Real Estate Investment Trust (REIT)	Funds raised from stock market	Special property companies that do not need to pay corporation tax if they pay 90% of their income to shareholders. Participating landlords need to transfer some homes into the REIT before it is floated on the stock market.	Allow housing associations access to investment from institutional investors. New regulations in the Finance Bill removes the entry Requirement and allows a longer period for payment plus other simplifications.	Up to now entry and timing requirements have ruled out residential REITS. Even in the USA residential REITS have proved difficult partly because of management costs.
Public-private partnership				
Community Land Trusts	Private sector and government	Community retains the land ownership and may impose conditions to maintain affordability into perpetuity. Purchasers pay only for construction costs.	Enables land to come forward that meets community objectives; major impact on affordability.	So far, very small scale – more suitable in rural areas although could potentially operate in regeneration areas.
Special Purpose Vehicle/Joint Venture	Housing associations and private developers	A project company is set up by a housing association and a developer for the development of new affordable housing or the refurbishment of existing housing.	Projects have to undergo significant due diligence; well suited for large complex projects.	More expensive to raise finance because not secured on housing association assets. Housing association needs to contribute at least 5–10% of project funding at the start.
Local Asset Backed Vehicles (LABV)/ Local Housing Companies	Local authorities and the private sector	Special purpose vehicle owned 50/50 by the public and private sector partners. The local authority invests property assets into the vehicle which are then matched by the private partner.	Transfer some risks to private sector; incentivise private sector to invest and deliver over longer term (10–20 years); more flexible than Private Finance Initiatives.	Only applicable to local authorities with a decent estate portfolio; complex and expensive to set up

NATIONAL HOUSING FEDERATION

Funding future homes: an evidence base

Provides an insight on:

- The background to the current housing crisis, including demographic shifts, variations in tenure preference and the changing nature of housing need
- The present and historical funding environment for government investment in affordable homes
- Meeting wider housing need and housing associations role in offering a range of housing solutions
- The financial capacity of housing associations to fund new supply
- An evaluation of alternative development and funding models that could support the provision of new homes. This analysis is presented in more detail in the appendix.

The National Housing Federation is the voice of affordable housing in England. We believe that everyone should have the home they need at a price they can afford. That's why we represent the work of housing associations and campaign for better housing.

Our members provide two and a half million homes for more than five million people. And each year they invest in a diverse range of neighbourhood projects that help create strong, vibrant communities.

Cover picture: Philip Wolmuth/reportdigital.co.uk

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