

Cambridge Centre
for Housing &
Planning Research

Funding future homes: An evidence base



UNIVERSITY OF
CAMBRIDGE

NATIONAL
HOUSING
FEDERATION

Funding future homes: An evidence base

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Introduction

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

Housing associations produced nearly half of all homes built in England last year (NHF, 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 their contribution to new supply.

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

To ensure that this vision is underpinned by robust evidence the Federation commissioned Cambridge Centre for Housing and Planning Research to produce the background evidence presented here.

This background paper provides empirical details about the context in which housing associations are operating and how this might evolve in the future. It clarifies approaches to meeting future needs and explores funding options and existing mechanisms that might be harnessed. The purpose of the paper is to provide a robust evidence base to support analysis, thinking and discussion with the sector and stakeholders on the future shape of investment in affordable housing.

An executive summary and list of discussion questions is available from www.housing.org.uk

1: The housing crisis: an evidence base

Summary:

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.

1.1 An overview of current affordable housing need and demand

Need, demand and demographic change

The Government indicates that there are 1.4m households that are currently waiting to buy a home in England (CLG, 2012) Indicators of overcrowding and increasing densities of occupation, rising homelessness acceptances as well as sharing and concealed households all point to increasing needs compared with traditional requirements.

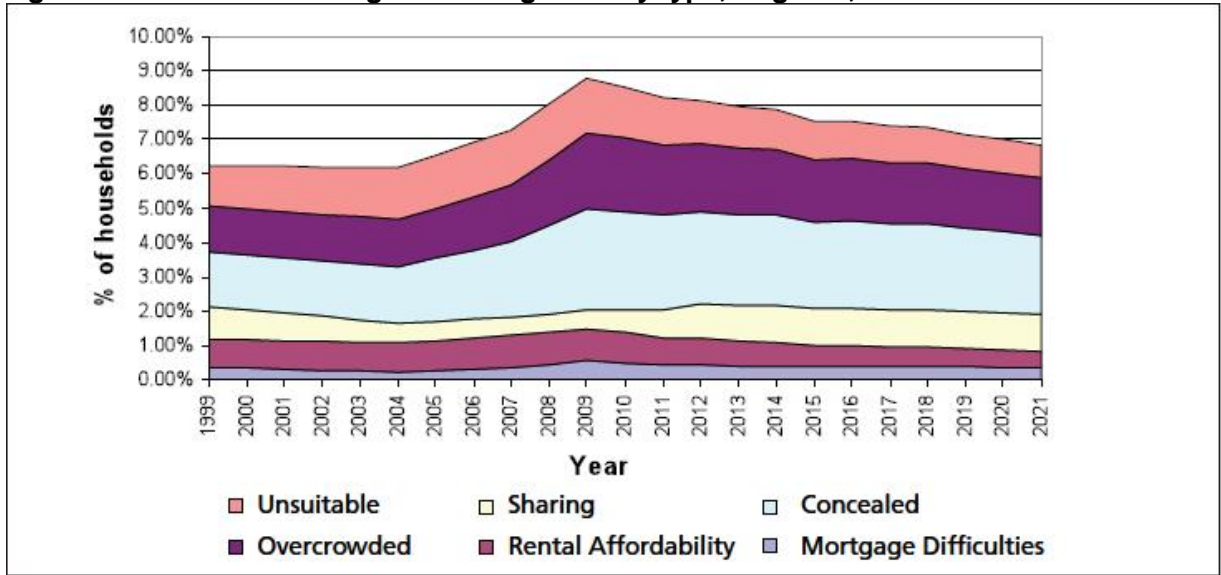
There was a massive shortfall in net new output in relation to the previous government's targets, not just because of the financial crisis but also because of the longer-term lack of supply response. The recent joint *Housing Report* suggests that the number of households will continue to increase by around 230,000 a year as compared with a new housing supply of 102,730 in 2010 and an average of around 150,000 a year over the last decade or more (Chartered Institute of Housing, Shelter and National Housing Federation, 2011). Evidently households are still forming at an rapid pace while substantial levels of unmet need remain in

the market, and housing 'need' if not 'demand' is only likely to increase in times of economic hardship.

In its recent Housing Strategy the Government accepts that supply is lagging behind requirements. However, it does not attempt any detailed assessment of current and future needs (CLG, 2011). Underlying this approach is a view that the market should be the main determinant of provision and there is no such thing as housing need as opposed to demand.

The most systematic attempt to estimate housing need in England suggests a housing requirement backlog of 8.8% or 1.99m homes in 2009 (Bramley et al, 2010). Figure 1 shows this backlog broken down by type of need. The rise in concealed and sharing households reflects the serious pressures now existing in England's housing market.

Figure 1: Estimated backlog of housing need by type, England, 1999–2021



Source: Bramley et al, 2010

Adding this backlog to the current shortfall in terms of new homes being generated gives a real sense of the gap that has to be filled. Clearly supply and household formation are linked, as the work by Meen et al (2005) and Bramley et al (2010) shows. The more homes provided, the more households are formed, clearly indicating substantial levels of hidden need.

The reality is that whatever measure was used to quantify the scale of the backlog, the numbers would be far higher than the Government could fund and the market could supply in the short to medium term – and perhaps even into the longer term. Although a core issue here is whether the economy improves, in which case more housing will be required, the underlying demographic pressures are unlikely to alter significantly as a result of changes in the economy. This means that the overall need for housing is likely to remain, even if the market remains stagnant.

1.2 How has demographic change affected housing need?

The mid-year population estimates for 2010 showed the strongest population growth for almost 50 years, up by 470,000 compared with mid-2009. However, commentators argue that current UK population projections are too high. Recent increased levels of net immigration are likely to decline in the near future when poor employment prospects stimulate outward migration. Even taking these factors into account, and assuming a continued decline in the number of people per household arising from increasing longevity and higher divorce and separation rates, estimates suggest the UK population will reach 76.5m by 2025. This would imply that number of households is likely to increase by around 2.5m from 2011 to 2020. (Office of National Statistics, 2011)

The potential growth in population and households is the core driver of the need for additional housing in the future. The number of households is forecast to continue to increase until 2020. However, the pace is slightly slower in the early years and picks up after 2015. This could reflect two things. One is the lower propensity among immigrants to the UK to form separate households. The other is that house prices, and importantly a lack of mortgage availability and restrictions on loan-to-value ratios, make housing less affordable, causing younger people to delay forming separate households and instead to continue living with family or friends.

Tables 1 to 4 give the supporting evidence by region and suggest that growth continues to be concentrated in southern regions, particularly London.

Table 1: Population (all ages)

	Population ('000)			Change from 2011	
	2011	2015	2020	2015	2020
East of England	5,885	6,115	6,410	230	526
East Midlands	4,538	4,684	4,875	146	336
London	7,868	8,141	8,466	273	598
North East	2,601	2,643	2,699	42	98
North West	6,942	7,038	7,170	95	228
South East	8,564	8,828	9,177	264	613
South West	5,340	5,512	5,740	172	400
West Midlands	5,487	5,600	5,751	112	263
Yorkshire and the Humber	5,351	5,527	5,753	177	402

Source: Office for National Statistics (ONS). Note: Mid-year base. Errors due to rounding.

Table 2: Population (working age: 16–64 male/ 59 female)

	Population ('000)			change from 2011	
	2011	2015	2020	2015	2020
East of England	3,545	3,626	3,723	81	178
East Midlands	2,781	2,816	2,854	35	73
London	5,275	5,436	5,597	161	323
North East	1,602	1,596	1,580	-6	-22
North West	4,250	4,232	4,198	-18	-52
South East	5,188	5,262	5,345	74	157
South West	3,166	3,210	3,259	44	92
West Midlands	3,307	3,317	3,323	10	16
Yorkshire and the Humber	3,324	3,392	3,454	68	130

Source: ONS. Note: Mid-year base. Errors due to rounding.

Table 3: Population (older: 65 male/ 60 female and over)

	count ('000)			change from 2011	
	2011	2015	2020	2015	2020
East of England	1,235	1,353	1,486	117	250
East Midlands	934	1,022	1,126	89	192
London	1,070	1,113	1,184	44	114
North East	539	580	632	41	93
North West	1,394	1,492	1,607	98	214
South East	1,772	1,930	2,115	158	343
South West	1,248	1,360	1,489	113	241
West Midlands	1,120	1,201	1,295	82	175
Yorkshire and the Humber	1,046	1,127	1,226	81	180

Source: ONS. Note: Mid-year base. Errors due to rounding.

Table 4: Households

	count ('000)			change from 2011	
	2011	2015	2020	2015	2020
East of England	2,500	2,632	2,802	132	301
East Midlands	1,933	2,024	2,138	90	205
London	3,346	3,491	3,682	145	335
North East	1,138	1,174	1,219	36	82
North West	3,000	3,092	3,210	92	210
South East	3,592	3,749	3,956	158	365
South West	2,320	2,431	2,574	111	253
West Midlands	2,294	2,368	2,466	74	172
Yorkshire and the Humber	2,284	2,396	2,539	113	256

Source: Author's estimate based on CLG. Note: Mid-year base. Errors due to rounding.

Couples with no children were the most common household type in 2009–10, at 36% of all households. They were also the most common household type in owner-occupation (44%) and the private rented sector (26%). In social housing the most common household type was a single person aged 60 or over, accounting for almost a quarter of all households in this sector. There were higher proportions of single parents in the rented sectors; 16% of social renters and 12% of private renters were lone parents with dependent children, compared with only 3% of owner-occupiers.

Overall, 10.3m household reference persons (HRPs) (48%) were married or civil partners, 2.3m were cohabiting and 3.6m were single. A further 5.3m were widowed, divorced or separated. Owner-occupation was the most common tenure for all groups, regardless of marital status, although there were considerable variations. The highest rate of owner-occupation (83%) was found among HRPs who were married or in a civil partnership, and the lowest rate (42%) among HRPs who were single. Some 1.0m single householders rented in the social sector and 1.1m in the private rented sector. Divorced or separated householders were equally likely to be owners or renters.

The number of lone parents is projected to increase and the number with three or more children will rise by 70% by 2020. This probably reflects increasing rates of relationship breakdown. The housing implications are twofold. First, single parents are the most likely to live in social rented housing, are among the poorest households and have significant needs in terms of help with financial management, parenting skills, childcare and entry into the labour market. Second, if the other parent is to maintain a relationship with the children, then they also need a large

enough dwelling for the children to stay overnight. This implies that the automatic reaction to the projected increase in single-person households – that we need more one-bedroom dwellings – is not valid. Older people may need extra space for relatives or carers while younger people may need space for their children.

1.3 The changing nature of housing tenure

In the last two decades rapid changes to the landscape of housing tenure have had, and will continue to have, a strong impact upon both the housing market and the way investment in homes works. There are currently 21.6m households in England (excluding institutions such as nursing homes or halls of residence). Recent trends in tenure in England, as evidenced by the English Housing Survey, are shown in Table 5. The table identifies the rapid growth in private renting and the recent fall in the home ownership rate – with the proportion falling from 2002, but actual numbers not until 2008 due to the rapid increase in the number of households. Social renting has also fallen from 20% to 17% over the last decade.

Table 5: Trends in tenure, 1999 to 2009/10

	Owner-occupiers	Social renters	Private renters	All tenures
	%	%	%	(thousands)
1999	69.9	20.2	9.9	20,163
2000	70.6	19.5	10.0	20,320
2001	70.4	19.5	10.1	20,403
2002	70.5	19.2	10.3	20,662
2003	70.9	18.3	10.8	20,739
2004	70.7	18.3	11.0	20,758
2005	70.7	17.7	11.7	20,932
2006	70.1	17.7	12.2	21,092
2007	69.6	17.7	12.7	21,178
2008	69.3	17.7	13.9	21,407
2008–09	67.9	17.8	14.2	21,530
2009–10	67.4	17.0	15.6	21,554

Sources: 1999 to 2008: ONS Labour Force Survey; 2008–09 onwards, English Housing Survey

Most regional housing markets broadly reflect this national pattern, with the exception of London, which had far higher proportions of private (23%) and social renting (23%) than other regions and correspondingly lower home ownership at only 53%. This figure is 5% below the figure for 2001. Over the same period the number of private rented units has increased by over 80%. The northern regions have higher levels of social renting, while southern regions have higher levels of private renting. The highest levels of home ownership are in the South West (73%), South East and East Midlands (both 72%). This shows that where incomes are low or house prices are high (or both these factors are present), owner-occupation declines in favour of renting – whether social or, increasingly, private sector.

The rapid changes in tenure over the past decade are not wholly the result of the financial crisis. In particular owner-occupation among younger households has been falling since the early 1990s. Increases in mortgage funding in the early years of the 21st century fuelled demand from existing owner-occupiers and buy-to-let purchasers (often the same people) rather than first-time buyers, who faced growing affordability problems due to the lack of supply.

High levels of migration have supported growth in the private rented sector, which has also expanded to meet the needs of other poorer households and those unable to access mortgage finance. There has been a shift in the mix of affordable homes from social rent towards low-cost home ownership. Even so, the data suggests that since 2007 more than a million households that would have become home owners before the crisis have been unable to do so. This means that both households and dwellings have moved across into private renting and other households have not formed. However, the recent public attitudes report by Communities and Local Government suggests that, although there are some variations by income, there is still a strong preference to buy amongst all tenure groups of all ages (CLG, 2011d). Although the preference to buy is less strong amongst renters than owner-occupiers, data such as that presented in table 6 still clearly show that the shift from owner-occupation to the private rented sector has been largely a result of economic necessity, rather than tenant choice.

Table 6 Tenure Preferences by British Social Attitudes Survey Year, 1996 to 2010

Survey year					
	1996	1997	1998	1999	2010
All	%	%	%	%	%
Would choose to buy	85	84	84	86	86
Would choose to rent	15	15	15	13	14
Don't know	1	1	1	1	1
Not answered	*	-	*	-	*
<i>Base</i>	<i>3072</i>	<i>1153</i>	<i>2695</i>	<i>2718</i>	<i>2795</i>
Owners only					
Would choose to buy	94	92	93	94	95
Would choose to rent	6	7	6	5	5
<i>Base</i>	<i>2113</i>	<i>773</i>	<i>1829</i>	<i>1878</i>	<i>1887</i>
Renters only					
Would choose to buy	62	65	63	66	68
Would choose to rent	37	34	37	34	32
<i>Base</i>	<i>901</i>	<i>346</i>	<i>851</i>	<i>807</i>	<i>878</i>

Source: CLG (2011)

1.4 Affordable housing supply: the status quo

The fundamental driver for the building of new affordable homes is housing need. The relationship between supply, housing need and demand in the UK is a complex one, and not necessarily related to the financial health of the nation. However, though new housing supply has been in decline for many years, the evidence to date indicates that the financial crisis and subsequent recession has had a marked impact on housing supply. Housing starts for instance fell heavily from 2008 but started to pick up in 2009, plateauing at around 25,000 to 30,000 per quarter. Completions fell more slowly but have stabilised around similar levels. The latest data from CLG suggest that there is no significant sign of improvement (Figure 2; CLG, 2011a).

Table 7 gives a useful overview of the output of affordable housing, whether new-build or other sources across the spectrum of activity (CLG, 2011). It highlights the complex pattern of arrangements now in place. The most recent figures are particularly bad because of the interregnum between the stimulus package and the Affordable Rent regime – which is intended to provide 170,000 affordable homes by 2015.

Table 7: Trends in the gross supply of affordable housing by type of scheme, England, 2001-02 to 2010-11

England	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09 _R	2009-10 _R	2010-11 _P
Social Rent, of which:	26,810	23,960	22,660	21,670	23,630	24,670	29,640	30,900	33,210	39,170
Homes and Communities Agency (new build)	17,510	16,590	16,600	16,560	17,400	18,180	21,700	23,420	27,270	30,780
Homes and Communities Agency (acquisitions)	8,140	6,420	4,290	2,610	2,410	2,360	3,390	2,900	2,650	3,200
Other Homes and Communities Agency Schemes	-	-	-	870	920	950	660	490	130	250
Local authorities	60	200	190	100	300	250	310	490	370	2,800
of which HCA grant funded (new build) ³	..	..	..	..	..	..	..	..	..	1,820
Section 106 (nil grant) new build: total ⁴	1,070	720	1,580	1,530	2,550	2,750	3,450	3,430	2,140	1,930
of which, reported on IMS	-	-	-	270	960	900	1,450	1,030	820	510
Private Finance Initiative ⁵	40	30	-	10	60	180	140	170	650	210
Intermediate Affordable Housing ²	6,210	8,970	15,410	15,800	22,350	19,630	23,530	24,600	24,800	21,460
Intermediate Rent, of which:			280	1,510	1,680	1,200	1,110	1,710	2,560	4,520
Homes and Communities Agency (new build)	..	..	260	680	1,370	1,110	1,050	1,690	1,910	2,380
Homes and Communities Agency (acquisitions)	..	..	30	830	310	90	60	20	650	2,140
Low Cost Home Ownership, of which:	6,210	8,970	15,120	14,280	20,680	18,430	22,420	22,900	22,240	16,940
Homes and Communities Agency (new build)	2,040	2,330	3,710	5,570	7,570	9,240	12,550	11,490	14,170	13,980
Homes and Communities Agency (acquisitions)	2,270	4,550	8,850	5,800	7,710	3,050	3,510	6,640	5,640	450
Other Homes and Communities Agency Schemes ⁶	-	-	-	-	490	570	130	40	-	-
Section 106 (nil grant) new build: total	1,060	1,250	1,550	1,900	3,810	4,440	4,910	3,440	1,590	1,570
of which, reported on IMS	-	-	-	430	1,170	1,280	2,180	1,150	740	560
Assisted Purchase Schemes ⁷	840	830	1,010	1,020	1,100	1,130	1,320	1,290	850	940
All affordable ¹	33,020	32,920	38,070	37,470	45,980	44,300	53,180	55,500	58,010	60,630

Source; CLG 2011

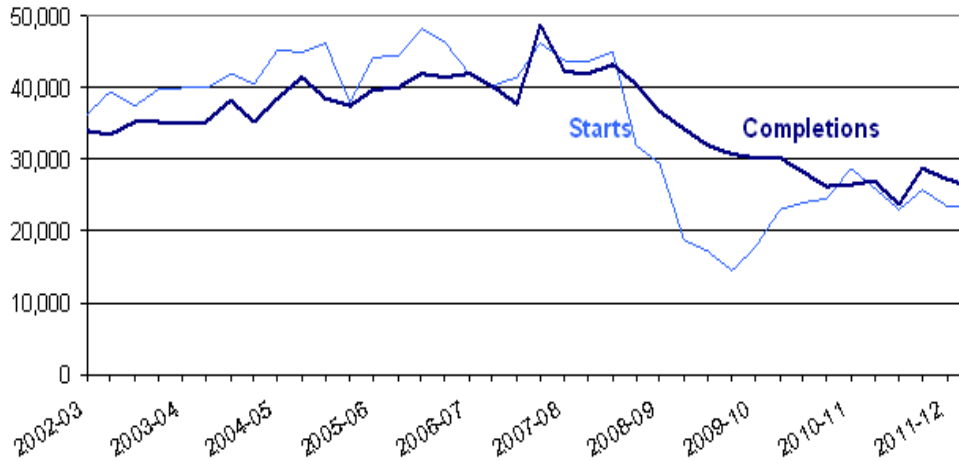
Table 8 shows net housing output (CLG, 2011). This comprises new homes including conversions and changes of use minus demolitions. The table shows 50,000 to 60,000 homes being created via the affordable housing programmes, suggesting that roughly half of annual output is now coming from the affordable housing sector. It is worth noting that this sector also accounts for the majority of demolitions as part of regeneration work, but the figures for new starts demonstrate the viability of the sector. Anecdotal evidence suggests that 80–90% of all new homes benefit from the provision of on-site affordable housing, through the improved cash flow generated by the affordable units for developers.

Table 8: Components of net housing supply, 2007-08 to 2010-11, England

	2007-08	2008-09	2009-10	2010-11	Change 2009-10 to 2010-11
New build completions	200,300	157,630	124,200	117,700	-6,500
plus					
Net conversions	9,020	8,640	6,230	5,050	-1,180
plus					
Net change of use	17,640	16,640	13,600	11,540	-2,060
plus					
Net other gains	1,020	270	970	1,810	840
less					
Demolitions	20,500	16,590	16,330	14,890	-1,440
gives					
Net additional dwellings	207,370	166,570	128,680	121,200	-7,480

Source; CLG, 2011

Figure 2: Seasonally adjusted trends in quarterly housing starts and completions, England 2002/03 to 2011/12



Source: CLG, 2011

Discussion question:

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

1.5 Future housing need

The number of households in England is currently projected to increase by 235,000 per annum to 2033. This compares with about 255,000 per annum to 2026 from the last projections – but is still somewhat higher than the 2004-based projections on which housing requirements were estimated. The projection makes an adjustment for lower household representative rates between 2000 and 2009 – but takes no further account of the apparently continuing decline in rates especially among younger people. Nor does it take account of the lower household representative rates of recent migrants.

Table 9: 2008-based household projections – analysis by household type

	2001	2006	2011	2016	2021	2026
(thousands)						
Couple households (married & cohabiting)*						
No children	6,966	7,137	7,358	7,628	7,819	7,979
One child	1,725	1,627	1,607	1,617	1,627	1,589
Two children	1,902	1,802	1,727	1,677	1,673	1,645
Three children or more	848	828	812	805	830	847
All couple households	11,441	11,394	11,504	11,727	11,949	12,060
Lone-parent households*						
One child	754	852	970	1,097	1,231	1,334
Two children	465	514	571	636	717	743
Three children or more	219	241	270	302	344	378
All lone parent households	1,341	1,607	1,811	2,035	2,292	2,495
One person households	6,304	7,024	7,773	8,558	9,340	10,194
Other households	1,341	1,318	1,301	1,287	1,264	1,268
All households	20,523	21,344	22,398	23,608	24,843	26,016

Source: Holmans and Whitehead, 2011

The new projections give new evidence on family households. The number of households with children is expected to rise by over 650,000 between 2001 and 2026. At the same time the number of couples with children is projected to fall by 400,000; this implies an increase of over one million lone-parent households.

About two-thirds of these households will have only one dependent child – but there is also an increase in the number of lone parents with three or more children. The biggest increase in absolute terms is still in one-person households – a rise of nearly 4m, which is a 60% increase, between 2001 and 2026. This is the group most likely to be affected by the continuing impact of the financial crisis.

The 2006-based projections allocated higher proportions of the increase in households to the Midlands and the North as compared to earlier estimates. This apparent trend has now been partially reversed – with higher proportions projected in London, the South East and the East of England. The shift back is probably in part the result of the ripple effect of house price rises outwards from London.

There are some uncertainties in the population projections that underlie the household projections. One is whether the fall in household representative rates among younger people is simply a postponement or a more profound shift. Another is the two-point base period for the projections for household types, which it will be possible to test against the results of the recent population census. The lower household representative rate among recent migrants is a further uncertainty, especially given the assumptions of continuing high rates of net immigration.

Housing demand and need

Table 10 gives a preliminary analysis of the 2008-based household projection in terms of the division of the net increase in dwelling stock between the market and social sectors. The market sector comprises owner-occupation and private renting without the use of housing benefit, while the social sector includes social renting plus private renting with the aid of housing benefit.

Table 10: Newly arising demand and need for housing in England 2005–2026

	Market sector (000s)	Social sector (000s)	Total (000s)
Projected net increase in households	3,467	1,205	4,672
Secondary residences	240	0	240
Vacant dwellings	+115	+20	+135
Replacement of social sector relets 'lost' by earlier Right to Buy sales	-486	+486	0
Total demand and need for a net increase in the dwelling stock	3,336	1,711	5,047
Annual averages	167	86	252
(Annual averages, previous estimate)	(169)	(72)	(242)

Source: CLG 2008-based household projection and Table 7 of Holmans et al, 2010.

The analysis is preliminary because detailed figures by household type and average are not yet available. However, a comparison with the 2004-based household projection used in earlier work for Shelter (Holmans et al, 2010) shows an additional 10,000 net additions a year to the stock of dwellings required to meet newly arising need and demand. This increase consists entirely of additional need falling on the social sector. The higher projected need in the social sector is the consequence of a much higher increase in lone-parent households, and a smaller increase in couple households, in the 2008-based projection compared to the 2004-based projection.

The implications for housing requirements

Lone parents tend to need assistance with their housing – either in the social rented sector or with local housing allowance in the private rented sector. One-person households are much more likely to be in the private rented sector. There are concerns about increased overcrowding among those with children as well as 'under-occupation' among the increasing number of couples with no dependent children. But the biggest crisis remains simply the numbers of additional homes required.

Projections can never be completely robust. The continued growth in household numbers at well over 200,000 a year appears inevitable, unless the economy collapses completely. The biggest absolute growth continues to be in one-person households whose housing circumstances are most varied and in some cases uncertain. Housing pressures will probably be more concentrated in the South and East. The projections suggest a large-scale shift towards a higher number of lone-parent households that are likely to need more assistance with their housing as well as other necessities. On current trends there is likely to be both more overcrowding and more under-occupation.

Need for intermediate housing

What Table 10 does not show separately is the intermediate market. An attempt to estimate the future demand for intermediate tenures using an econometric model was carried out for CLG in 2007. The results were plausible and in line with the findings of qualitative and descriptive studies such as Clarke et al (2007). However, the overall power of the model in explaining low-cost home ownership (LCHO) take up was weak. This was partly because of data limitations and partly because supply constraints prevent potential demand from being realised.

Holmans (2010) reviewed the available methods of estimating need for intermediate housing. There are substantial differences between the approaches reviewed. Holmans concludes that his own approach would appear to have the most advantages from a policy point of view. In particular, it takes explicit account of how many households within the income range that is unable to afford market housing but would not be eligible for social rent or housing benefit would actually want LCHO if it was available. The income ranges used by Holmans tie up well with data on the characteristics of those who did take up intermediate housing in recent years. At a regional level, his analysis suggests that intermediate housing might meet about 30% of the total need for affordable housing (ie, social renting and intermediate together).

The real question, however, is whether these trends reflect fundamentals, and are therefore likely to continue, or merely reflect recent market conditions that might change in the future. In particular, the rapid growth in the private rented sector reflects an increase in the availability of buy-to-let mortgages in the early 2000s, which helped to fund new-build properties of better quality and generally inner city locations compared with traditional private renting. This new supply may have attracted certain groups of people back into city centres to enjoy the lively lifestyle in locations where they could not afford to buy. As house prices rose and affordability became an increasing problem for first-time buyers, the availability of attractive private rented units met a need. The question is: was that a temporary need, reflecting a delay in house purchase, or a permanent change in housing preferences? With the global financial crisis and the ongoing credit crunch in the UK, resulting in reduced loan-to-value ratios and a need for large deposits, the apparent change in preferences in favour of private renting may reflect constraint rather than choice.

The private rented sector has also been increasingly used to house low-income households that are unable to access social rented housing. They can afford private renting with the aid of housing benefit and so the private rented sector is filling a gap in housing provision for such households. Again, this raises the question of whether private landlords will continue to be prepared to let to such households, or whether they will want to sell their property when the housing market recovers (Ball, 2011). Interestingly, this question was asked during the 1990s when the sector was filling the same role, and the answer seems to be that despite large increases in house prices, the sector, far from declining, started to grow.

If the growth in the private rented sector does reflect changes in tenure preferences, over the longer term the structure of the housing market could come increasingly to include some attributes of longer-term landlordism based on rental rates of return. This is prevalent in

Germany, where there is a relatively small owner-occupied sector and a large private rented sector.

Discussion question:

- *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

Summary

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.

2.1 Housing and economic growth

Building new homes helps to stimulate and grow the economy. The wider relationship between housing investment and the economy has of course been a long-debated issue but a number of studies including the Barker review in 2004 highlighted the impact of housing on the economy, and the effect of house price volatility on UK competitiveness.

An underlying issue is the extent to which it is housing market pressures that generate the volatility or rather whether macroeconomic volatility generates large variations in housing demand against an inelastic supply. A particular concern at present is that demand is extremely low both because of the lack of mortgage funding and, particularly, a lack of confidence. If there were to be a positive shift in attitudes the result could be rapid price increases.

It is worth noting that the picture currently being painted of 'low demand' might better be described as 'frustrated demand' in certain areas of the market. Despite relatively high levels of unemployment and low levels of consumer confidence, there remains a substantial group of potential first-time buyers with steady incomes amongst whom demand for home ownership is high. This group typically has the capacity to pay a mortgage, but are shut out of the market because of affordability issues. This is driven by high house prices and the restrictive lending environment which together have created the need for prohibitively high deposits. This demand is very much in evidence in the long waiting lists for shared ownership homes. The shutting out of first-time buyers brings even greater stagnation to the housing market, but does not necessarily indicate a lack of demand *per se*.

In the current environment with the cutback in government expenditure and the downturn in the economy there has been considerable interest in the positive relationship between housing and the economy. Housing does not impact directly on productive capacity, so the case for housing being an important part of the growth agenda has to be based on the economic impact of additional new construction. The economic benefit is derived from additional employment and wages in the economy and long-term savings generated by better homes in terms of expenditure in public services such as health and education. These relationships make a strong case for prioritising further government investment in housing.

A large number of reports in recent years have provided research evidence of the strength of the relationship between housing and economic growth (CBI, 2011; DTZ, 2006; FTI, 2011; Glossop, 2008; LEK, 2009; Pro Bono Economics, 2011; Regeneris and Oxford Economics, 2010 and Whitehead and Travers, 2011, in the London context). Between them these reports show how housing contributes to the economy, how significant it is in terms of particular measures and what multiplier effects it might have. Some of the key findings include:

- Housing activity accounts for 17% of construction activity and 3% of gross domestic product (GDP) (CBI, 2011).
- 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 (CBI, 2011). This compares favourably with other sectors such as banking and finance, which hovers at 1.7 and is more powerful in impacting the economy than reducing tax (FTI, 2011). Others have argued that the multiplier effect is even greater; for instance, consultancy LEK suggest a much higher figure of 8.5 applies.

- There is significant spare capacity in the housing sector and leakage in the expenditure outside the UK is relatively low (FTI, 2011). This means that more of the money spent on housing stays within the UK economy than in the case of many other industries (FTI, 2011; Regeneris, 2010).
- Housing has a significant impact on labour mobility, with both firms and people highlighting it as a serious problem (FTI, 2011; DTZ, 2006).
- Investment produces higher tax returns and benefit savings (LEK, 2009).
- Changes in the housing market between 2007 and 2009 contributed to around a third of the total fall in UK GDP during this period (Regeneris, 2010).
- The costs and availability of housing in London are cited as a major problem by some 80% of employers in London (CBI, 2011; Whitehead and Travers, 2011).

This evidence clearly indicates the serious wider ramifications of the shortage of affordable housing, particularly on employment, where there is a significant impact for both employers and employees. It is clear that the Government, including the Treasury, accepts that housing activity is an important stimulus to the economy. The evident desire to stimulate new house building and to help maintain the development industry is part of that understanding, giving rise to initiatives such as the Get Britain Building fund and the Regional Growth Fund. However, other aspects of the relationship between housing and the economy have been accorded less value and importance. The major contributions to GDP made by housing-related consumption such as repairs, maintenance, improvements, solicitors and surveyors' services, and purchases of white goods and furnishings are often overlooked.

Discussion question:

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

2.2 Evaluation of previous investment models

Since 1989 there has been a dramatic shift in the capital funding of affordable housing from public grants to private finance. Successive governments have reduced grant as a proportion of Total Scheme Costs (TSC). In the early 1990s, private finance had the status of a 'top-up' grant. Public grant levels made up 75% of the cost of most schemes. Since then government has increasingly seen gearing private finance against grant as a way of maximising outputs and switching the costs of new provision away from direct government investment to housing associations. However, this in turn reduces the capacity of the sector to increase the number of new homes it can build.

Despite the pressure on grant rates since 1997/8, capital investment has risen steadily (and then sharply) to a peak of more than £3.5bn p.a. in 2009/10.¹ In particular, 2008/09 saw a dramatic rise in public subsidy as part of the Government's stimulus package to help ensure that house building could continue during the downturn. The Kickstart programme addressed the difficulties of 'shovel-ready' stalled sites and focused upon liquidity issues arising from current market conditions. The Homes and Communities Agency (HCA) provided 'Investment Support'

¹ Piers Williamson, Presentation to the Housing Forum, 22 July 2011.

for up to 30% of the Total Scheme Cost in the forms of loans, equity or gap funding (Department of Town & Regional Planning, University of Sheffield et al, 2011).²

Since 1989 housing associations have built 453,000 new homes (Department of Town & Regional Planning, University of Sheffield et al, 2011). The pattern of completions between 1989 and 2009 demonstrates the impact that varying capital subsidy can have on housing delivery. The new financial framework ushered in a period of high productivity (at around 30,000 homes per year), which continued into the mid-1990s. However, as gross annual investment declined sharply and bottomed out in the mid-1990s and early years of the 21st century, so too did productivity. Completions averaged around 15,000 per year. Although completions rose steadily through the first decade of the century, it was not until 2008/09 and the unprecedented levels of capital subsidy that accompanied the financial crisis that new-build levels for housing associations once again rose to over 25,000 per year.³

Discussion question:

- *Does the mixed funded model remain the best mechanism for government investment in affordable homes?*

Investment Partnering

In 2003, the Housing Corporation announced its intention to select the most suitable housing associations as Investment Partners (IPs). The selection process led to a significant reduction in the number of housing associations with which the corporation directly worked (National Housing Federation, 2007). The evidence suggests that this approach was associated with a reduction in costs. Aside from clear benefits in terms of grant rates and staffing resources, the move to investment partnering has arguably not brought the wider gains possible from the new strategic partnerships that formed between housing associations as a result.

Investment partnering led to strategic partnering between associations. This brought a substantial number of associations not selected by the Corporation into formal partnerships with IPs. In some cases a partnership created a platform for gaining benefits across a considerable range of activities, but many partnerships were formed only to access funding. Consequently, their success was mostly measured by how much funding they accessed (National Housing Federation, 2007).

Discussion question:

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

² For limited evaluations on Kickstart (bidding rounds 1 and 2) see: http://webarchive.nationalarchives.gov.uk/20110303161527/http://www.homesandcommunities.co.uk/kickstart_housing.htm

³ This assessment comes from various sources but relies heavily upon Pawson and Wilcox, 2011; Whitehead et al, 2008 and Piers Williamson's presentation cited above (for the interaction with capital subsidy).

Value for money

Despite grant levels falling for over two decades, there has been no systematic study of the impact of this upon value for money. From available evidence it is known that the move to Investment Partnering was associated with certain types of efficiency gains. On average, the 2004/05 funding programme was 9% cheaper than that for 2003/04 (National Housing Federation, 2007). However, despite headline grants having fallen, it cannot be stated that the savings result simply from supply chain improvements or increased competitive pressures. External factors including differential land costs, opportunistic pricing from land banks and Section 106 agreements also need to be taken into consideration (Campbell-Tickell, 2006).

There is also a wider debate about how the investment agencies assess value for money. Typically assessment focuses on average grant rates and numbers of new homes and does not consider what type of housing is being delivered in what locations. The Federation has suggested some principles that should underpin any investment model.

For the sector and government investment in new homes should:

- Support the development of affordable homes at scale, with a range of tenure options
- Be viable for housing providers to deliver
- Support flexibility and innovation
- Offer excellent value for money for the taxpayer
- Consider quality, tenure and need – not just number of units and average grant rates
- Have a balanced approach to risk sharing between government and housing associations
- Enable a range of providers to be able to develop, ensuring maximum use of sector capacity
- Offer genuine freedoms and flexibility to local government and its housing partners to meet local housing need.

For people in housing need investment in new homes needs to:

- Deliver homes at a scale that meets local need
- Support the delivery of a range of affordable homes at different price points and tenures
- Deliver sufficient numbers of specialist and supported housing, larger and rural homes
- Offer solutions for areas of the country which have lower land values
- Enable regeneration activity to be funded
- Be able to respond flexibly to local needs
- Support the creation of jobs and wealth in local economies.

Discussion questions:

- *What housing tenures should future investment programmes support? In the future should the investment agency continue to stipulate which products it will fund?*
- *Are there factors limiting value-for-money improvements and is there more the sector can do to improve efficiency savings?*

- *How should government assess value for money?*
- *What principles should underpin government investment in new homes?*

Programme management

Improvements have been made in the investment agencies' programme management approach. The move towards two-year bidding cycles with continuous market engagement, to cater for unforeseen development opportunities was widely welcomed. The introduction of long-term (five-year) funding on strategic sites and Partnership Plus, to provide extra flexibility for the best-performing IPs in the 2008/10 programme, were broadly welcomed as sensible additions to the programme management framework (Housing Corporation, 2008).

Despite this shift, there was no noticeable reduction in the level of scheme-by-scheme scrutiny. When queried at the pilot programme stage in 2005 less than half of associations (44%) agreed that Investment Partnering had resulted in less scheme-based scrutiny (Housing Corporation, 2008). While not quantified, it seems likely that many associations shared these frustrations (even under the 2008/10 programme). This obviously has had huge resource implications on both sides of the equation.

Similarly, many associations remained frustrated with the lack of transparency over allocations. They were also concerned by the additional development costs created by the unwillingness of the Homes and Communities Agency (HCA) to release grant upon commencement of development rather than upon completion (Housing Corporation, 2008, pp. 7, 11). The sector strongly welcomed the recent news that the HCA will release up to 75% of grant for developments started on-site up until the end of March 2012 under the new framework; a measure that has been adopted to increase the number of housing starts. Numbers were brought alarmingly low by the hiatus of the contract negotiation process involved in the Affordable Rent programme.

In relation to the HCA's programme management approach there have been some concerns that *despite the Government's rhetoric of flexibility, there is considerable risk that the new framework has to a large extent replaced one rule-bound and constrained investment model with another.* The sector has long argued that genuine freedom from rule-bound investment models would give housing associations the space to develop imaginative solutions working with local partners to meet local needs (National Housing Federation, 2011).

Discussion questions:

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

2.3 The Affordable Homes Programme 2011–15

In the 2010 Comprehensive Spending Review (CSR) the capital budget from the Government to build affordable homes was cut by 63%. The Government has allocated resources of £4.5bn for the Affordable Homes Programme (AHP) over the next four-year period to deliver up to 170,000 homes. The new model is driven by revenue funding from higher rents through the introduction of a new affordable rent – at up to 80% of the market rate. This will be charged on most newly built homes and a proportion of relet properties.

To date, the HCA have published details of successful bidders who, subject to contract, are expected to deliver the 80,000 new affordable homes. This gives headline information on the new homes to be delivered by HCA operating area. Within this, nationally 79% of the new homes will be for affordable rent and 21% affordable home ownership. This masks significant regional variation, with 26% of the programme in London being for affordable home ownership compared with 10% in the North East, Yorkshire and The Humber. It also gives the percentage of total homes that will be larger, supported housing or in rural areas. At 29%, 9.5% and 9% respectively, these are broadly comparable with the 08-11 programme.

Information relating to individual providers is being released incrementally as they sign contracts with the HCA. Until all contracts have been signed information remains incomplete, so it has not been possible to include a more detailed analysis in this evidence base.

The new investment model leads to a much greater level of development risk being transferred to housing providers and requires much higher levels of borrowing to deliver new homes. A more detailed analysis of the potential financial implications of the new AHP is included in section 5 of this paper. Essentially, the impact of the new funding model will be to increase the amount of resources that housing associations need to invest to support the delivery of affordable rent homes, which in turn will limit future funds available to support new housing supply. Modelling by *Social Housing Magazine* and Savills has indicated that associations will need to find an additional £10bn to finance the 2011–15 development programme (*Social Housing Magazine*, 2011a).

Some concerns about the implications of the AHP that the Federation and its members have raised include:

- The model fails to support the delivery of a range of housing tenures to be flexible in meeting a range of local housing needs
- The uncertain future for affordable home ownership products that remain in high demand and help people on moderate incomes to buy a home
- The impact of a number of fundamental weaknesses and risks inherent in a revenue-based model of development for both government and providers
- The impact of welfare reform on the viability of the new investment framework and the conflict in policy especially regarding larger homes and under-occupation

- Concerns about considerable local authority opposition to the new model and the impact that this could have on delivery
- Erosion of housing association capacity and longer-term sustainability implications
- Affordability and work disincentive implications for tenants paying the new affordable rent.

It has also been suggested that the model does not work well for smaller housing associations that would be keen to work with the Government. The current, and indeed past, investment model plays to the strengths of larger providers. Anecdotal evidence suggests that many smaller housing associations feel excluded from the AHP and for some the only option is to join a consortium. This may be partly due to value-for-money assessments which may work better for housing associations with national stock that are able to utilise capacity from higher rents in high value areas to reduce average grant rates in lower value areas, or for schemes with high development costs. In the future the ability of smaller housing associations to access the capital markets efficiently or easily could become a point of concern.

Discussion questions:

- *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?*

2.4 What is the Government's solution to the problem of supply?

The Government's recent housing strategy, *Laying the Foundations*, sets out a number of measures designed to improve the difficulties outlined. A key element of the strategy is its expectation of building 170,000 new affordable homes by 2015, an increase from the 150,000 originally estimated.

Other measures include:

- Direct help for private sector new-build into the future with a £400m Get Britain Building fund that will support building firms in need of development finance. This will help to unlock stalled sites which have planning permission and are otherwise shovel-ready
- An industry mortgage guarantee scheme backed by government which aims to help 100,000 mainly first-time buyers to buy new-build housing with mortgages of up to 95% of value
- A reinvigorated Right to Buy offer which aims to enable social tenants to purchase their homes – with the intention of allowing a one-to-one replacement of affordable homes
- The release of public sector land for house building based on 'buy now, pay later', reducing the funding requirements faced by house builders
- The potential for renegotiating S106 to improve financial viability.

These measures will undoubtedly help, although they will take time to have an impact. The first is the least complex and follows on from the earlier stimulus package, yet it will not start until next year. The second is more problematic as it may take some time to clarify the rules. The scheme will require managing and is likely to take some time to put in place. The third is equally complex, particularly for housing association tenants with preserved Right to Buy, as the sale proceeds go back to the local authority rather than the association. The discounts will need to be large, and the promise to replace in full depends on ability to borrow effectively and to charge higher rents for the new properties.

Bringing public land into use for housing always takes time, given the backlog of undeveloped schemes, and there are few incentives to local authorities to release land when prices are so uncertain. Furthermore, the ability for developers to renegotiate Section 106 agreements could prove a serious blow to affordable development. Local authorities will be encouraged to adopt Community Infrastructure Levy (CIL) charges instead of Section 106 agreements from April 2014, meaning that payments from developers will no longer be earmarked specifically for affordable housing. If CIL is set at an unrealistically high level, developers are unlikely to pay out a second time for affordable homes.

If there is to be a serious step change in output this would need to encompass large-scale developments involving new and extended towns as well as major regeneration projects and large public sector sites. Some of the proposed changes in the planning system via the National Planning Policy Framework will provide powers to support such development – but past evidence suggests that any such change will take decades rather than years, especially as there is so little public funding available.

Tackling aggregate need and demand is important but we cannot ignore the real challenges of boosting supply as much as possible within the existing framework and the Government's housing and planning strategies. Whether these strategies will be sufficient to meet identified requirements is discussed further below.

Taxation and fiscal policy

Both affordable housing provision and wider housing supply are affected by taxation and fiscal policy. The current shape of the housing market in England and the flows of households and funds into sectors is partly a product of the tax and fiscal framework. As it currently stands, home ownership remains fiscally favoured despite the scrapping of mortgage interest tax relief and its treatment as a consumption good, 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. It was the subject of close examination in the Mirrlees Review (IFS, 2010) and it was also considered in the Joseph Rowntree Foundation Housing market Task Force (JRF, 2011). Most recently the Chartered Institute of Taxation held a seminar on the subject of property taxation (CIOT, 2011). There is continued pressure to reform Stamp Duty Land Tax (SDLT) and to move from a 'slab' system to a graduated basis. There have been some adjustments recently in terms of the way SDLT is collected in terms of bulk purchases and there has been pressure for a SDLT holiday to help boost housing market activity (CML, 2011). Other areas of debate include the VAT levy on home improvement but not on new-build, the new Community Infrastructure Levy (CIL) (discussed in the Appendix), reform

of property taxation and of inheritance tax. There is also some debate on a 'mansion tax'. The proposed changes in legislation on residential real estate investment trusts (REITS), included in the Finance Bill may have the most immediate impact (see below).

As all this suggests, fiscal policy and housing is in 'play' to a modest degree. Government has tried other levers, notably with respect to financial regulation, recognising that taxation is the least popular way forward. However it is possible that it will creep up the agenda. With the Government more interested in house price stability and with the new Financial Policy Committee charged with containing price bubbles, there is a new interest in this area.

Discussion question:

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

2.5 Planning policy context

Over the last 20 years the delivery of new affordable housing England has become very dependent on support through the planning system, especially through Section 106 agreements. In recent years these have provided support worth billions of pounds a year for new affordable homes, as well as crucial access to sites for developing housing associations, especially important in London and other high-value areas.

However, the current policy context for the provision of affordable housing through the planning system is one of great change. The Government is reviewing consultation responses to the proposed National Planning Policy Framework (NPPF) ahead of its expected finalisation by April 2012. Local planning authorities are moving towards the introduction of the Community Infrastructure Levy (CIL) with a scaled back S106 agreements focused upon site specific mitigation and affordable housing.

The New Homes Bonus has been introduced, providing an incentive to local authorities to produce more housing. They will receive the equivalent council tax for each new home delivered for six years. Government has promoted its decision to award an additional bonus of £350 per year for each new affordable home delivered, equivalent to 25% of the council tax for a Band D home. However, due to the way the council tax tapers work, there will still arguably be much greater incentive for hard-pressed local authorities to look to maximise their bonus payments by accepting fewer high-band new homes, rather than affordable homes which are mostly in the very lowest bands. Also, research by the Centre for Cities suggests that the payments on offer under the New Homes Bonus as a whole are unlikely to be effective, and that they might have to be made up to three times more generous to have the desired effect (Centre for Cities, 2011).

The New Homes Bonus will reward local authorities for long-term empty homes returned to use in the same way as it will reward them for new homes that are built. It will thus act as an incentive for local authorities to have effective empty homes strategies. Rewards will only be paid for a net increase in housing, meaning that local authorities could miss out on rewards for

new homes built if regeneration and other programmes lead to significant demolitions and possibly if vacancy rates are not reduced.⁴

The changes to S106 are a cause of much concern to the Federation and developing housing associations as they fear a significant reduction in the delivery of affordable housing. Affordable housing delivered in this way is the outcome of negotiations between planning officers and developers, and while planning policies must include targets for affordable housing that are based on robust evidence of housing need, these targets inevitably form an upper limit to negotiations. The new CIL will be an upfront charge with 'first call' on new development, leaving affordable housing vulnerable to being negotiated away in order that the scheme remains financially viable. Also the NPPF, with its greater scope for the use of commuted payments and a different approach to viability considerations, could potentially result in significant reductions in the amount of affordable housing that can be developed by housing associations with support from the planning system.

Discussion question:

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

⁴ Empty Homes Welcomes New Homes Bonus Scheme, February 2011. <http://emptyhomes.com/latest-news/empty-homes-welcomes-new-homes-bonus-scheme/>

3: Investment challenges

Summary:

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 levels of grant per unit 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.

As described in the previous sections, housing need in the UK is characterised by an undersupply of affordable housing and growing numbers of households, many of which are priced out of home ownership. This, along with significant demographic change and the more recent effects of the economic crisis, has caused a dramatic shift in the housing market.

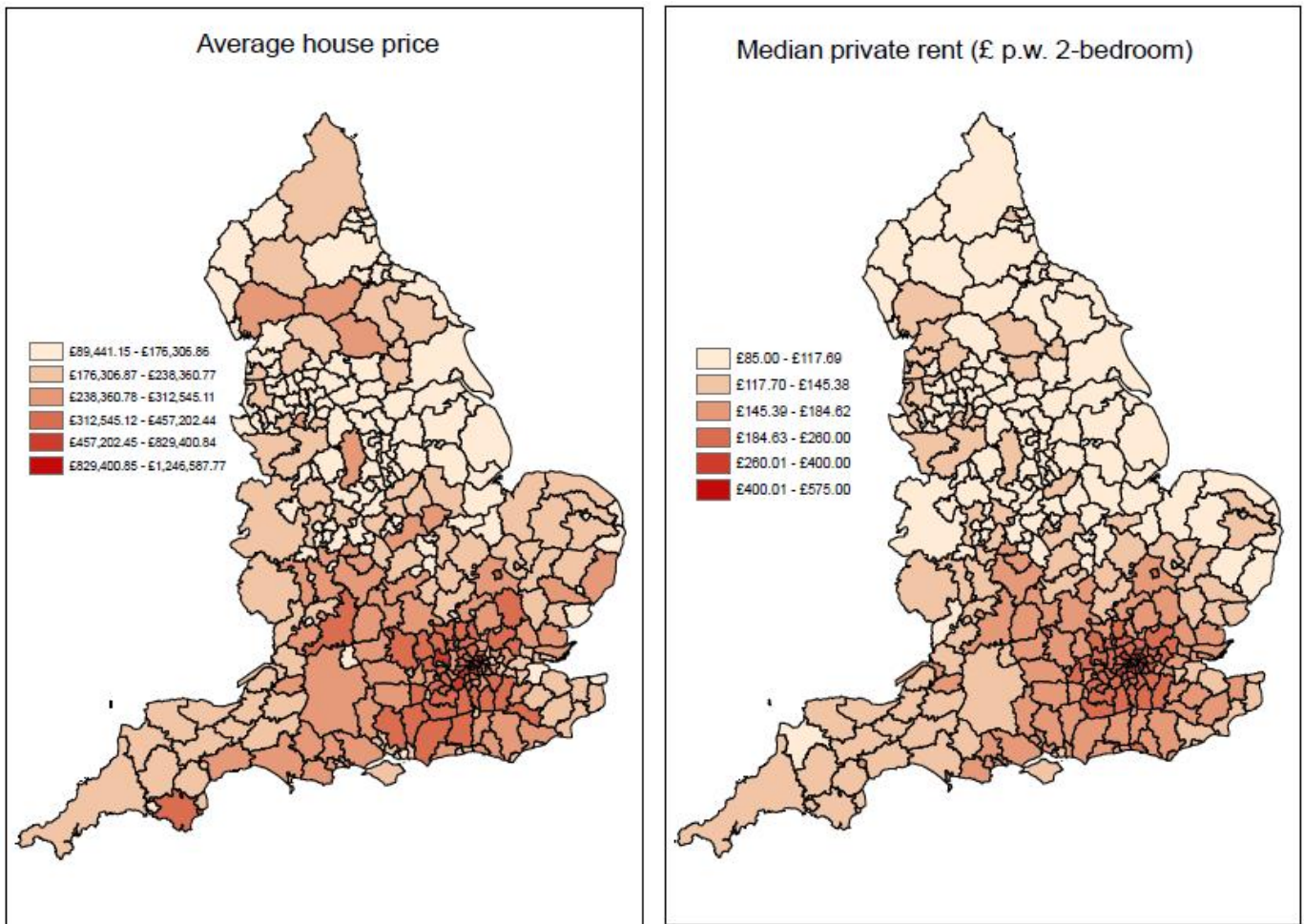
These issues are echoed throughout the affordable housing sector, but there are parts of the market which face their own specific challenges. The problems of creating an investment model that caters for both low and high value areas, for instance, are recurrent. High quality specialist and supported housing, for the disabled, elderly and those with other support needs is expensive to build, and difficult to develop along market principles. This means such housing will usually sit uncomfortably within a revenue-based investment model. Rural housing, which is so crucial to realising the potential for rural economies, presents different challenges from urban development, as does developing affordable, family-sized homes. Finally, areas in need of significant regeneration in order to rebuild collapsed housing markets are an especially big challenge in an environment where public investment is heavily restrained.

3.1 Low value and high value areas

Clearly the geography of the English housing market is very varied. There are high value areas and low value areas. Although high value is common in southern England, and London and the South East in particular, there are pockets of high value and low value housing across the whole of England reflecting local and regional circumstances.

The geography of the housing market is well captured in house price maps. Clearly 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 they hold. Two examples are given below.

Figure 3: Average house prices, 2010 and average private rent for 2-bedroom properties, September 2011



Source: CLG Live Table 585.

Source: Valuating Office Agency

Another measure of pressure comes from the balance between households and dwellings. Table 11 shows the balance between households and dwellings for London and for England as a whole. London stands out as having a much closer alignment between the number of dwellings and households than elsewhere in the country – with almost certainly now more households than dwellings. The North West and the West Midlands on the other hand have at least 4% more dwellings than households – not a large gap by international standards, but suggesting much less pressure in the market.

Table 11: The extent of relative pressure in London

Household / dwelling balance 2008				
Region	Households (m)	Dwellings (m)	Balance	Balance %
London	3,244	3,248	+ 4,000	0.10%
England	21,731	22,398	+ 667,000	3.10%

Source: CLG Live Tables 109 and 403

Another important factor is the relationship between income and the cost of housing, as incomes are usually higher in higher-priced areas. These regional differences have a considerable impact on household affordability and mobility as well as on local economies and employers. Table 12a presents some evidence on the relationship between lower quartile private rents and lower quartile earnings by region. Again at the regional level the most pressurised areas are in London, followed a long way behind by the South East. The lower differentials between social rents in different geographical areas reduce affordability differentials across the country. However, with the introduction of the affordable rent model, the costs of social housing will soon mirror the patterns of low and high value areas found in the private sector.

Table 12a: Affordability at the lower end of the private rented market

Private rents /LQ ASHE earnings, by region	2002-03	2007-08	2008-09
East Midlands	0.40	0.45	0.45
Eastern	0.47	0.55	0.53
London	0.58	0.64	0.72
North East	0.43	0.41	0.45
North West	0.41	0.43	0.48
South East	0.49	0.55	0.59
South West	0.53	0.54	0.56
West Midlands	0.43	0.47	0.49
Yorkshire and the Humber	0.45	0.41	0.49
ENGLAND	0.49	0.54	0.58

Private rents to 2007/08 are VOA referred rents. 2008/09 private rents are imputations using 2008/09 Hometrack lower quartiles and rent/stock relativities from 2007/08 VOA referred rents.

Table 12b gives similar data for housing association rents and reflects the fact that lower social rent differentials reduce the variances in affordability across the country.

Affordability in London is only just below the national average, a situation which will soon change in the light of the Affordable Rents regime.

Table 12b: CORE HA rent / LQ ASHE earnings, by region

Region	2002/03	2007/08	2008/09
East Midlands	0.30	0.31	0.31
Eastern	0.31	0.32	0.33
London	0.28	0.31	0.33
North East	0.30	0.29	0.29
North West	0.29	0.29	0.30
South East	0.31	0.34	0.35
South West	0.34	0.34	0.34
West Midlands	0.30	0.31	0.32
Yorkshire and the Humber	0.31	0.29	0.30
ENGLAND	0.30	0.31	0.32

The geographical fluctuations of the housing market also present significant investment problems. With a revenue-based model as provided by the Affordable Homes Programme, it is predicted by many that low value areas will lose out. Where there is little difference between 'market rent' and social rent, the ability to set rents at 80% of market rent loses much of its meaning in terms of generating sufficient revenue to sustain investment.

Discussion question:

- *How should government investment in housing be targeted?*

3.2 Supported and specialist housing

Strong and sustainable communities respond to the needs of all their residents, including the most vulnerable and marginalised. Settled homes and support are vital in helping vulnerable adults to lead stable lives and maximise their life chances and opportunities to live independently. This is a prerequisite for greater wellbeing and independence as well as a way of increasing the success of support and sustained engagement with other services.

A successful and sustainable housing model for the future must provide for appropriate general needs and specialist housing solutions across the country that meet the needs of vulnerable, disabled and older people, and facilitate the delivery of care and support services. This means continued investment in high quality, transformative accommodation for a wide range of client groups including those suffering mental ill health, people with drug and alcohol issues, teenage parents and care leavers. It also means tackling one of the most pressing problems of 21st century society: diverse, good quality housing, support and care options for an ageing population.

Successive governments have invested in supported and specialist housing because of the outcomes it can deliver for vulnerable people, as well as the wider benefits to the community. In a climate where public funding is an increasingly scarce resource, it will

be crucial for future housing investment models to recognise the long-term savings to the public purse in terms of expenditure on health, social care and the criminal justice system that are achieved through preventative and crisis intervention care and support services delivered in high quality supported housing.

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. Naturally this adds an extra measure of uncertainty to the future of specialist housing especially since Supporting People budgets were de-ringfenced in 2009. Subsequent drastic cuts to local authority budgets in the Comprehensive Spending Review 2010 mean that councils are under increasing pressure to use Supporting People money to plug gaps in funding for other services. These cuts and the introduction of the Universal Credit cap are also likely to be of particular relevance in this sub-sector.

Developing supported and specialist accommodation has often been challenging. 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 to make them happen. The availability of specialist housing with care and support has been recognised as an important element of national and local government client-group strategies and policies, including the drugs strategy, mental health strategy and rehabilitation of offenders. However, there are long-standing obstacles to delivery. The new challenges of the AHP, combined with dramatic local cuts to revenue funding for services delivered in supported and specialist housing, compound these difficulties and create a serious threat to the future delivery of new specialist and supported housing.

This section sets out the key issues facing current and future provision of supported and specialist homes, considers potential new routes and mechanisms for delivery, and raises critical questions for future investment models. Perhaps the key challenge for organisations will be to plan for future delivery at a time when the operating context is changing dramatically. These changes are likely to affect the viability of existing schemes, which also raises new questions and potential risks for the development of new specialist housing.

Delivery of supported and specialist housing

A number of funding sources contribute to developing specialist housing, though the proportion made up by public capital grant funding has been falling, not least under the AHP. Specialist housing can utilise similar resources as those used for general needs housing funding, which include loans, discounted land and, under the AHP, income from affordable rents from conversions across the wider stock of the landlord. Smaller specialist organisations may have fewer of these options open to them, unless they are part of a consortium.

For specialist housing there is also a key difference in the connection between capital and revenue. Both share the need to receive rent to pay for housing management and service the housing debt secured against the property. However for supported housing, revenue streams need to be secured or commissioned by local health or local authority

bodies to fund the care and/or support services, which are an integral part of the scheme.

The HCA did not set specific national targets for numbers of supported and specialist homes as part of the National Affordable Housing Programme (NAHP) 2008–11, relying instead on regional and local strategic prioritisation. However, it has stated an aspiration that approximately 10% of capital funding should be for supported and specialist homes. At the end of March 2011, when the programme finished, the HCA had allocated £1,017m for over 18,150 new units of supported and specialist housing from the NAHP 2008–11. This represents approximately 10% of all NAHP 2008–11 allocations for rent. Of the £1,017m, approximately 57% (£579m) of these allocations are for housing for older people and 43% (£438m) for all other vulnerable client groups.

Between 2008 and 2011 the HCA invested £80m in the Places of Change Programme to transform hostels, day centres and other homelessness provision. This included remodelling existing projects as well as delivering new units to be genuine places of change, with better accommodation and communal areas as well as social enterprise and training schemes to help turn short-term accommodation into a real stepping stone to a more stable life. Over the duration of the programme 111 projects were supported.

In addition to the HCA's standard New Build Home Buy shared ownership product, there have been two specific products of shared ownership for older and vulnerable people: Home Ownership for People with Long-term Disabilities (HOLD) and Shared Ownership for the Elderly (SOE). However, the changes to the level of Support for Mortgage Interest in the June 2010 budget has since made HOLD mortgages less viable.

In the context of the 63% cut to the capital investment the HCA has continued its broad commitment and stated that 9.5% of the homes funded under the AHP will be supported housing and housing for older people.⁵ At the time of writing, whilst contracts with the HCA are being signed, there is no published information regarding the proportion of specialist and supported homes split between different client groups. Naturally the best outcome will be for all specialist and supported client groups to be represented in the allocation of grant, reflecting the ambitions of the wide range of specialist and supported providers wishing to develop new housing solutions under the current investment framework.

During the bidding process, the HCA published additional guidance on developing supported and specialist accommodation. A key part of the flexibility offered to the sector for this was on the calculation of a meaningful comparator market rent. However, in spite of this flexibility and strong corporate commitment from the HCA, the new investment framework presents a number of considerable challenges to supported and specialist housing:

- The inclusion of service charges within the overall affordable rent has made some schemes difficult to finance. Service charges in some types of supported housing are traditionally very high, reflecting high levels of services required to manage the scheme.

⁵ Homes and Communities Agency website Affordable Homes Programme
<http://www.homesandcommunities.co.uk/affordable-homes>

- The impact of near-market rents on specialist projects. Providers potentially face higher financial risks due to higher rents and uncertainty regarding welfare and housing benefits, including Department for Work and Pensions' consultation and recommendations about the future of exempt accommodation.
- Prioritisation for supported housing and housing for older people was often unclear or absent in many Local Investment Plans.

As part of the AHP, the HCA has a particular funding stream for homelessness schemes, the Homelessness Change Programme (HCP), which builds on the Places of Change programme. As is the case with the AHP as a whole, the HCP has a more limited capital resource of £37.5m for projects for homeless people between 2011 and 2015. Funding has been allocated to local authorities, voluntary sector providers and around 30 housing associations to help meet commitments to support rough sleepers, and those at risk of sleeping rough, into more stable independent living. It has been estimated that this will result in approximately 1,200 new or improved bed spaces. This is most likely to remodel and improve existing provision and enhance the range and quality of positive activities for homeless people rather than delivering new bed spaces. The Affordable Rent requirements of the AHP apply to HCP schemes and therefore also present similar challenges.

A further funding programme within the AHP is for Traveller Pitch Funding of up to £60m. This is focused primarily on the provision of new or additional pitches on permanent sites for gypsies and travellers.

Funding remains available for the HOLD home ownership product and also Older People's Shared Ownership (OPSO), the revised term for the SOE product. Support for Mortgage Interest challenges remain and continue to affect the accessibility of the HOLD product.

Discussion question:

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

3.3 Rural housing

The Taylor review of rural housing highlighted the need for more homes in rural areas (Taylor, 2008). In particular the review criticised the oft-commended planning policy stance whereby larger settlements are declared 'sustainable' because they have a shop, school, pub, etc., and therefore all new development should be concentrated on such villages. This prevents small settlements that currently lack such facilities from ever being sustainable in planning terms – what Taylor terms the 'sustainability trap'. It would in principle be possible to achieve all requirements in larger 'sustainable areas' but the tensions between the two views have undoubtedly contributed to the large backlog of housing that currently exists in rural areas.

The Commission for Rural Communities reported that rural areas can and do make an important contribution to the national economy. Rural economies perform strongly but

could contribute much more if they were encouraged as they have an estimated £347bn per annum of unrealised potential contributions to the economy (Shucksmith, 2008).

Table 12: Comparing rural and urban economies in England

	Urban (excluding London)	Rural
Output (GVA)	£170bn	£178bn
Workforce (jobs)	5.2m	5.5m
Productivity index	97.4	97.3
Output change 2002–05	-2.4%	+5.6%

Source: Shucksmith, 2008

Discussion question:

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

3.4 Larger homes

In the owner-occupied market the provision of larger units is affected by the planning system and density requirements, by demand for larger units, the disproportionately low council tax, and particularly by the capacity to extend existing units. Evidence of downsizing is relatively limited as people get older. There is only a modest supply of larger homes in the private rented sector and what there is tends to be in the higher income segment. This is in part because private renting is seen as unsuitable long-term tenure for family households. In the social rented sector local authorities traditionally provided family homes while housing associations have a much higher concentration of dwellings for smaller households.

Housing associations own around 5,500 larger units accounting for less than 0.5% of the stock. The largest number and concentration of large units is in London, with 36% of the total of larger units in England, as compared to only 16% of the general needs stock overall. The North West, the West Midlands and Yorkshire and the Humber also have relatively high proportions of larger units. Southern regions excluding London have relatively fewer units. Areas with highly concentrated holdings of larger stock are mostly located in inner urban areas where the proportions of general-needs stock are also high. In only ten local authorities are there more than 100 larger units. Five of these authorities are in London, accounting for 53% of the total larger stock in London (Datspring, 2008).

Provision of larger units in the social sector, specifically in London and the South East, is also very directly affected by the new housing benefit and Local Housing Allowance (LHA) regime. As the maximum LHA and housing benefit that can be claimed is capped at £400 per week, many social (and private) landlords in high value areas may see increased numbers of tenants going into arrears. This makes social landlords' income streams vulnerable. Consequently existing lending agreements and the ability to borrow cheaply in the future are in question. Naturally this is likely to cause social landlords to become extremely risk averse when developing family-sized housing (always a challenge for associations in high value urban areas), as well as hampering their development funding sources in general. Associations may also receive increased demands from existing tenants for smaller properties, regardless of the real need for

more family homes, as tenants seek to avoid the effects of the housing benefit cap on their incomes.

Discussion question:

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

3.5 Design and Quality standards - Sustainable homes

In response to the challenge of global warming the Government has been leading the way in raising sustainability standards in new homes. All new homes in the UK will be required to be zero carbon from 2016. The Code for Sustainable Homes measures a new home against nine categories of sustainable design. Two of these categories, CO₂ emissions and water consumption, have mandatory standards. The Code uses a one to six star rating system to communicate the overall sustainability performance of a new home. While private developers need to carry out a Code assessment, they are not required to meet any specific level. However, changes to the Building Regulations, such as Part L and Part G will require meeting aspects of the Code, such as reducing CO₂ emissions and water consumption.

The NAHP required Code for Sustainable Homes level three from all new developments, and level four in London – this has been the case since 2007. The evidence presented in the cost review carried out by CLG in 2010 (CLG, 2010) suggests that on average moving from code level 2 to 3 adds about 2.5% to construction costs while moving to code 4 adds a further 6% or more. Above this level increases in costs are very large indeed – over 30% - in part because of lack of scale in provision. Housing associations' build costs have increased as they have to meet such higher standards, and the cost of building sustainably has remained high as only part of the housebuilding sector has been required to do so.

3.6 Regeneration

Housing associations are at the heart of regeneration work across the country, whether as key partners in former Housing Market Renewal Pathfinders (HMR) in northern and central England or development partners in regeneration of East London for the Olympics. Housing associations invest around £500m per year in over 6,800 neighbourhood projects, including programmes to improve the employment prospects of individuals and initiatives to tackle social exclusion.

There has been substantial progress in regeneration initiatives over the past decade backed by significant public investment, but this progress is being threatened by the recession and the focus on cutting the deficit. Declining property values and the withdrawal of funding from banks has undermined the viability of many developments. Many residential and commercial sites have been mothballed and others are in jeopardy as private developers nearing the limits of their financial capacity have withdrawn as partners.

The termination of housing market renewal area funding has affected the supply of homes in regeneration areas where poor housing conditions are widespread. The HMR initiative was a £2.2bn programme to regenerate the areas of the country where the problems of low demand and abandonment were most acute.

The withdrawal of funding for HMR has the potential to derail the substantial progress already made and means broken promises to local communities. To date the HMR programme has generated £5.8bn of economic activity, created 19,000 jobs in construction and related industries and helped maintain over 2,600 jobs in the construction industry each year. Unfortunately, it is difficult to envisage how it will be possible to mitigate the loss of public funding for existing regeneration projects. The programme was extremely wide ranging and made a significant difference to a number of low value areas. The Audit Commission said of the programme: 'HMR at a neighbourhood level helped to stabilise market conditions and provide a strong sign of change, with fewer empty houses, reduced crime, and more jobs and training opportunities, especially in those neighbourhoods more advanced in their programmes.'⁶ A recent study for the HCA of what was delivered, where and for whom found that roughly half of all new affordable homes built in the last ten years were built in areas that had not had any housing previously – such as airbases, hospitals and other brownfield sites (Crook et al, 2011). Most of the remainder, however, were located in or near areas with relatively high deprivation, in practice mainly part of remodelled social housing estates – a testament to the success of HMR pathfinders.

However the programme, which was originally envisaged to operate over a ten- to 15-year period, was cut short after only eight years. This has left many areas blighted by demolitions and empty homes scheduled for demolition. There is a great deal of anger in these 'ghost' communities as the promised new developments which were to take the place of unsuitable and derelict homes are unlikely to appear. The Government has recently announced some additional transition funding for the areas worst affected by the withdrawal of HMR Pathfinders. Though these resources are welcome, they represent only a small percentage of the work that was scheduled to be completed.

The simultaneous removal of regional strategic planning structures and the abrupt withdrawal of regeneration funding make it far more difficult to stimulate private sector activity in areas where markets are failing. Changing the nature of demand and closing the socio-economic gap between HMR areas and those around them are still extremely challenging ambitions.

Economic rebalancing is not just about the growth of the private sector but about tackling housing market decline. The link between investment in housing and new homes and the success of the economy means that integration of economic and housing strategies is critical for successful regeneration (Audit Commission, 2009). The Audit Commission calculates that each £1 spent on construction in HMR areas generates £2.84 in total economic activity and each new home built equates to at least 1.25 jobs created or maintained (Audit Commission, 2011).

Regeneration targets intervention in areas of market failure to address economic, social and environmental decline. Successful regeneration achieves positive outcomes in these

⁶ <http://www.audit-commission.gov.uk/housing/marketrenewalpathfinders/Pages/default.aspx>

areas that would be impossible without public intervention, whilst providing value for money for the public purse. Successful regeneration requires long-term public commitment, collaboration between many agencies and interests and can take around 15–20 years (Joseph Rowntree Foundation, 2008; CLG, 2009).

Discussion questions:

- *How can future investment programmes best support regeneration?*
- *How can we drive forward regeneration in the context of drastic cuts to public investment for regeneration?*

4: Meeting wider housing need

Summary:

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 through shared ownership, equity loans 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 equity loans, 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 (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.

4.1 Intermediate housing

Housing associations offer a range of housing solutions beyond rented housing to help people in housing need. The most common models are shared ownership, equity loans, rent to buy schemes and housing for older people. Below we set out some of the details.

A major reason for the growth in shared ownership provided by housing associations has been the importance of S106 agreements and the provision of land in mixed tenure developments. S106 agreements are informed by local needs assessments which split the identified housing need between social rented and intermediate housing. The incentives to housing associations to provide shared ownership and to recycle funds for further development have also generated significant increases in provision.

The affordable housing sector has been expanded in recent years to encompass a greater diversity of tenures. Two years ago there was a confusing variety of different names for intermediate housing products, but today only two products are available

through the HCA: traditional shared ownership provided by housing associations and an equity loan product for selected new-build properties.

4.2 Shared ownership

Housing associations have delivered shared ownership for over 30 years and it has helped over 170,000 households into home ownership. Shared ownership involves a housing association providing purchasers with a home in which they buy a share of the equity while the association retains the remaining equity. The association charges rent on its share, while the part purchaser obtains a mortgage to buy his or her share.

It has typically been marketed as NewBuild HomeBuy, though is now simply promoted as shared ownership. Together with a 125 year shared ownership lease, the purchaser buys an initial share of between 25% and 75% of the property value with a typical mortgage. They then pay a subsidised, capped rent of 2.75% of the value of the unsold equity at the point of initial sale, rising by RPI plus 0.5% annually.

In 2009/10, the average household income of shared ownership purchasers was £24,531 p.a (HCA data compendium, 2011).

4.3 Equity loans

Equity loans (or shared equity) has been subject to many policy and financing changes since it was introduced in the late 1990s. In its latest form it has been a programme to enable developers to clear their stocks and maintain output. Equity loans are effectively a low-interest or interest-free loan to enable a first-time buyer to meet the lender's requirement for a deposit of 20-25% of the value. Previous versions were mainly aimed at key workers and only later broadened to other first-time buyers unable to access home ownership.

In recent years the main product was marketed as Open Market Homebuy, but as this enabled people to buy homes on the open market it was criticised for doing nothing to increase overall housing supply (hence potentially merely fuelling demand and therefore house prices). Government responded to this by creating HomeBuy Direct, an equity loan only available on certain new-build property.

The current version is marketed as FirstBuy, which is an affordable housing deposit assistance equity loan scheme whereby eligible applicants meet 80% of the purchase cost of a suitable home and the remaining 20% is met by the HCA and the housebuilder. The purchaser owns 100% title to the property and can sell it on the open market, subject to repaying the two loans. The loans are interest free for five years, with an annual fee thereafter of 1.75%, rising annually by the increase in RPI plus 1%.

Although HomeBuy and FirstBuy aren't entirely recorded by CORE, the average household income for people purchasing through equity loans in 2009/10 was £32,291 p.a (HCA data compendium, 2011).

4.4 Rent to buy

Rent to buy, or Rent to HomeBuy as it is marketed, enables an eligible household to rent from a housing association for up to five years at below market levels. This provides the opportunity to save a deposit so that the household can apply to buy a share in the home at a later date. This scheme aims to help those who have insufficient savings to cover the costs of part purchase. The rent cannot be more than 80% of the market rent. Rent to buy is no longer funded under the AHP.

Discussion questions:

- *Do we have the right range of intermediate products? If not, what other products should the sector offer?*
- *What intermediate housing options should be funded with government support?*
- *Can we do more to increase the number of intermediate homes without public subsidy?*

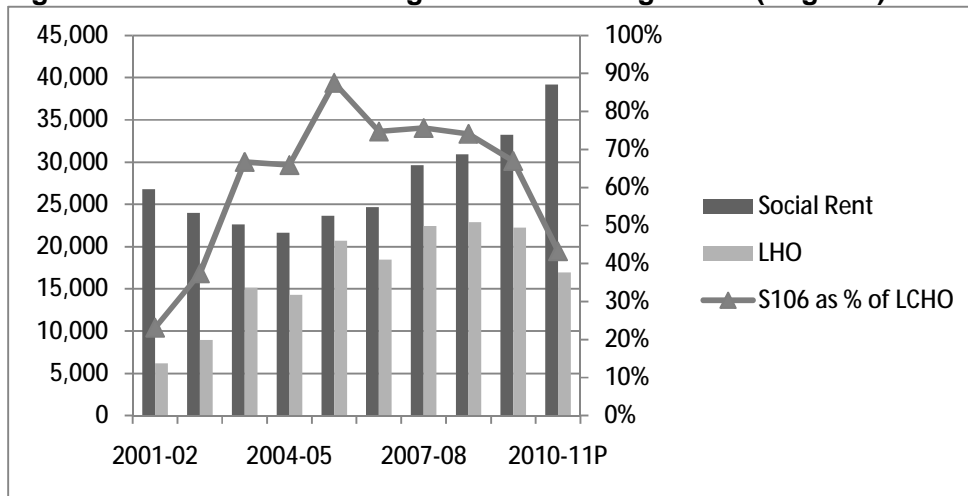
4.5 The scale of the intermediate market

It is difficult to establish the scale of the intermediate market. This is partly because equity loans are a second charge on the property, rather than a separate tenure, so sales are not recorded separately by the Land Registry but are included in all housing transactions. Those provided by the HCA do not include schemes offered by some private developers to help them shift newly completed stock.

Shared ownership is, however, recorded as part of affordable housing. This form of tenure has been growing. This growth has been closely associated with the increasing use of S106 to deliver affordable housing together with the mixed communities agenda. Local authorities have been concerned not to repeat the creation of large social housing estates, while developers have found shared ownership more attractive than social rented housing alone, as in principle shared ownership provides an opportunity for part purchasers to staircase up to full owner-occupation.

Figure 4 shows the growth in S106-funded intermediate housing in both absolute terms and as a proportion of all low-cost home ownership. The latest, provisional, data show further decline but perhaps not as sharp as expected.

Figure 4: Intermediate housing delivered through S106 (England)



Source: CLG Affordable Housing Supply Statistical Release 2011

In 2010/11 21,460 new affordable homes were in the form of shared ownership and equity loans, a fall of 13% since 2009/10. Previously the total had increased steadily since 200/01 (CLG *Housing Statistical Release*, October 2011).

Table 13 shows the proportion of S106 completions in each tenure by region for selected years. Until 2007/08 shared ownership as a proportion had been rising steadily, but more recent data reflect the impact of the financial crisis and HCA policies to concentrate on assisting stalled developments, often by increasing the proportion of social rented units.

Table 13: Proportions of S106 completions in each tenure by region %

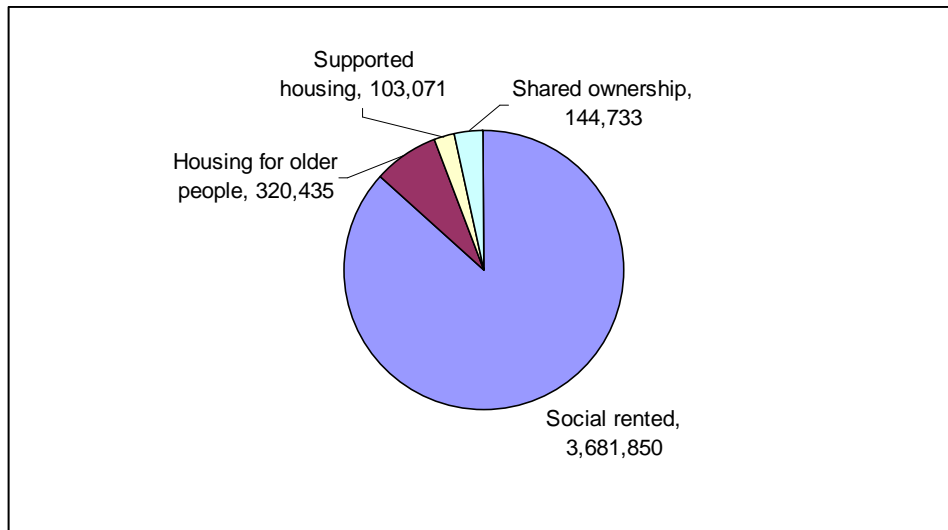
Tenure Year	Rent				Shared ownership				Other tenures (1)			
	2001/02	2005/06	2007/08	2009/10	2001/02	2005/06	2007/08	2009/10	2001/02	2005/06	2007/08	2009/10
North East	83	73	80	67	13	24	17	10	4	3	3	24
North West	63	46	29	64	11	37	49	20	26	17	22	15
Yorks/Humber	88	63	54	51	9	24	39	10	3	13	7	39
East Mids	59	54	50	56	13	40	43	23	28	6	7	21
West Mids	69	50	49	59	6	34	41	19	25	16	10	22
East	90	65	64	63	5	27	33	25	5	8	3	12
London	75	68	63	56	20	29	37	34	5	3	<1	11
South East	78	57	57	61	20	35	41	30	2	8	2	8
South West	82	60	55	62	9	35	34	16	9	5	11	22
England	77	60	57	60	13	33	38	26	10	7	5	15

(1) Other tenures include discounted market sale (up to 2007/08) and units of unknown tenure.

Source: CLG HSSA statistics, various years.

The latest data from the Regulatory and Statistical Return (RSR) shows that shared ownership now comprises 3.4% of the total affordable housing stock owned in England, or just under 1% of the total housing stock in the country. Other intermediate housing, notably equity loans, are not recorded in the RSR as housing association stock is not involved.

Figure 5: Affordable housing by tenure (England)

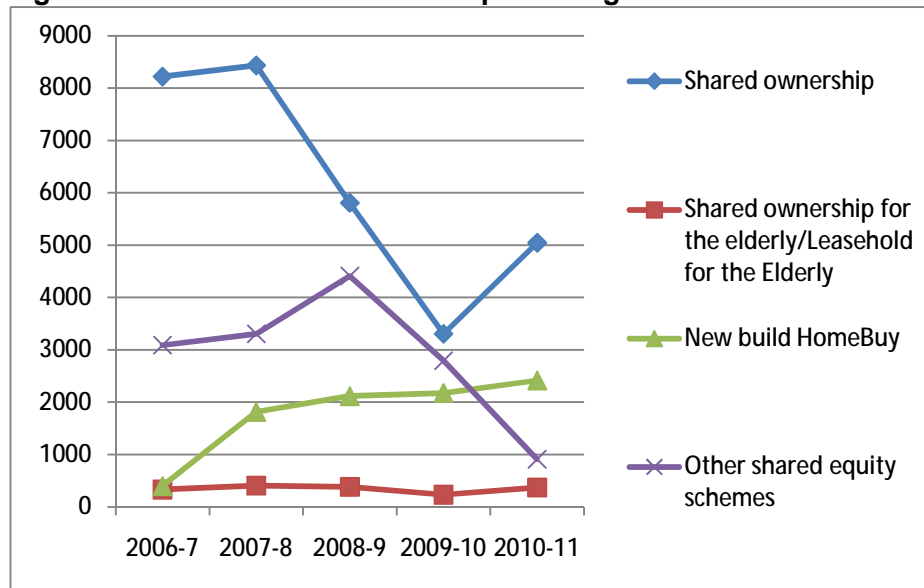


Source: RSR, 2011 and HSSA, 2010

The number of units in shared ownership has risen by 50% since 2002, and more than trebled from the 40,384 units in 1992, the first year the data was recorded by the RSR.

Sales of shared ownership dwellings were around 8,000 a year but have fallen in recent years as a result of the downturn in the wider housing market and buyers' difficulties in obtaining mortgage finance.

Figure 6: Sales of shared ownership dwellings 2006–2011



Source: RSR, 2011

4.6 Demand for shared ownership

Accurately estimating the level of demand for shared ownership is difficult (Bramley et al, 2010). However, an indication of demand might come from the waiting lists for HomeBuy Agents (HBAs). As of 31 March 2010 HBAs had over 137,000 live applications and in 2010/11 received nearly 76,000 applications (HCA data compendium, 2011).

Housing associations report difficulties in obtaining mortgages as a crucial factor in limiting effective demand in previous years, as well as competition with private equity loan schemes created by developers to sell stock in a difficult market (Whitehead et al, 2008; Burgess et al, 2009; Monk and Whitehead, 2010).

Under the AHP the central issue is likely to be insufficient supply to meet demand. This is because there is limited funding for intermediate housing as most funding is being directed towards the new Affordable Rent product. There will be just two standard options: shared ownership or equity loans, both branded HomeBuy outside London and First Steps in London.

Discussion question:

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

4.7 Housing for older people

Our society is ageing rapidly and the 'baby boomers' in particular are beginning to create new demand for greater choice in housing as people age. People's needs change at different rates and thus they have different needs and preferences, making it difficult to ensure that needs are met. There is a need for specialist housing for people with health issues, particularly dementia, which is set to increase and which cannot be met in traditional care homes. Estimates of the need for this type of housing are not currently available (although some work is currently under way, eg for the Greater London Authority and for Shelter/Joseph Rowntree Foundation).

The majority of older people in affordable housing live in general needs social rented housing. However, significant numbers also live in housing built specifically for elderly people. As shown in Figure 5, 320,435 households currently live in housing for the elderly, or sheltered housing as it is commonly known. Small numbers of older people also purchase under shared ownership terms via Shared Ownership for the Elderly, or Leasehold Schemes for the Elderly. A total of 373 households purchased under these two schemes during 2010 and 2011, a similar number to previous years.

Traditional sheltered housing is not always popular as it includes shared facilities which are no longer acceptable under improved housing standards. As a result much of it is being remodelled and some is being demolished. There is a strong case for planning policies which aim to retain the provision of such homes without losing the flexibility to be able to remodel or demolish parts of them.

There has also been an increasing debate over the potential for ethical equity release products. Equity release involves an older owner-occupier who retains ownership but sells a proportion of their property to release capital that could be used to fund crucial aids and adaptations to their home (CIH, 2009). Research by One Housing Group has shown that equity release is currently used to fund care and support for older people in only 1% of cases, compared to 70% of cases where it is used for home improvements or adaptations. Surveys and focus groups with older people have revealed that there is interest in using equity to fund care and support in old age, but that products need to be simple to understand, cheap to administer, flexible to adapt as care and support services develop, and meet a range of different personal circumstances (One Housing Group, 2009).

Discussion question:

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

4.8 Housing associations' role and potential in wider housing models

The introduction of the new affordable rented tenure, at up to 80% of market rents, and new fixed-term leases of as little as five years, both serve to lessen the distinction between market and affordable rented housing. Private developers already play a role in

the provision of affordable housing, notably via equity loan products, and the Government's new housing strategy proposes a greater role for profit-making organisations to compete with housing associations to provide affordable housing. Similarly, housing associations have recognised that there may be a role for them in managing private rented housing or indeed privatising some parts of their business. Some local authorities already have good relationships with private landlords whose stock they use to help accommodate homeless households or lease to those otherwise unable to access the private rented sector.

Housing associations have also begun to develop their own schemes which involve a mix of market, intermediate and social rented housing. Acting as developers, they do not have to make the large profit margins that private sector shareholders require, which places them in a more competitive position for land purchase. They are able to use market sales to cross-subsidise the other tenures and build to higher standards than private developers. One recent housing association scheme did not even require market housing to make it stack up – it included a mix of shared ownership, 80% rented and social rented housing.

The final section of this document evaluates potential development and funding models in more detail.

Discussion questions:

- *What role is there for housing associations in the private rented sector and what, if any, barriers are there to undertaking that role?*
- *What is the potential for the increased provision of market housing as part of the sector's investment offer?*

5: Financial capacity and rents

Summary:

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, ensuring 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.

5.1 Financial capacity of the housing association sector

The latest financial overview of the housing association sector was published in the *2010 Global Accounts of Housing Providers: Landlords' Financial Health*⁷ (TSA, 2011a). The report notes that:

- At a national level, the operating performance of the sector improved between 2009 and 2010. Turnover increased by 6% to £12.3bn in 2010. The overall operating surplus increased by £581m (35%) to £2.2bn, the

⁷ The global accounts include housing associations that manage more than 1,000 social homes. At 31 March 2010, 379 providers had over 1,000 homes. Within this group, there were 63 very large providers with over 10,000 homes. These very large providers manage 48% of all social homes in England.

operating margin increasing from 14% in 2009 to 18% in 2010. Such substantial improvement is the result of the fall in operating costs per unit in real terms due to ongoing progress towards meeting the Decent Homes standard and the efforts put into cost control. It also notes:

- An increase of over 100,000 units in management. The book value of the sector's housing assets has exceeded the £100bn mark.
- Rental income from social housing over £10bn because of the guideline rent increase of 5.5% in 2009–10.
- Global interest cover in excess of 100%.
- The stock transfer subsector moving into overall surplus because of the lowest level of stock transfer activity and the reduced level of expenditure on improvements by more mature stock transfer associations.
- Sector borrowing increased by £2.8bn during the year, and grant from the HCA increased by £3.1bn.⁸
- The use of bond financing has remained high. In 2009–10, £988m (2008–09, £986m) was raised on the bond market at rates between 5.42% and 6.35% (2009, 5.96–7.25%).

The sector's financial performance has been helped by the reduction in interest rates generally – the effective rate on all borrowing has fallen 0.5% from 5.3% to 4.8%. Associations have taken advantage of the low rates on variable rate debt, although the bulk of debt was fixed-rate, which the sector used to manage the risks of exposure to interest rate increases.

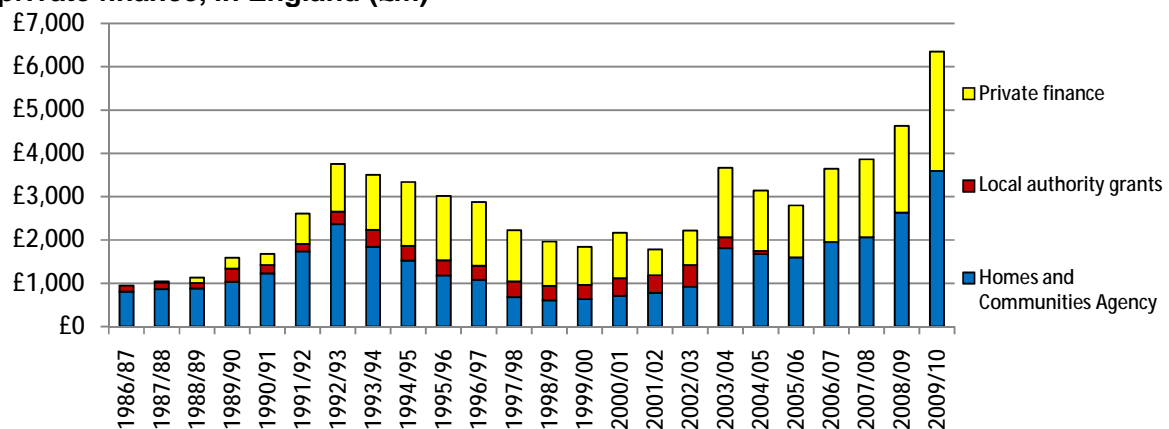
However, the sector is still working within a challenging operating environment because of last year's low and in some cases negative rent increases (in 2010–11, the guideline rent movement was a decrease of 0.9%), the increase in VAT in 2011, welfare reform, pressures on public funding and ongoing uncertainty and constraints in the financial and housing markets.

5.2 Funding structure

In order to produce dwellings, social housing organisations require a flow of capital, which can be channelled via a range and often a mix of vehicles including direct public expenditure as grants and via private financial institutions as loans. Falling rates of grant has led to private debt finance becoming the main source of investment in addition to housing associations' own equity.

⁸ Since the onset of the banking crisis, the HCA has effectively used grant to repair the capital base and secure the viability of some developing housing associations caught by falling property values and slow sales on their open market developments.

Figure 7: Housing association gross investment expenditure, including use of private finance, in England (£m)



Source: UK Housing Review Table 59

<http://www.york.ac.uk/res/ukhr/ukhr1011/compendium.htm#expenditure>

The proportion of private finance in housing association gross investment expenditure increased steadily from 2% in 1987/88 to 53% in 1997/98, and then fell to 43% in 2001/02. It rose to 47% in 2006/07 and 2007/08, and dropped slightly to 43% in 2008/09 and 2009/10. The latest Quarterly Survey of Housing Associations: June 2011 (Tenant Services Authority, 2011b)⁹ reports the continuous slowdown in housing associations' borrowing activities, with the number of active lenders offering new borrowing down to a handful.¹⁰ The survey reports that over the quarter ending 30 June 2011:

- The sector reported total agreed loan facilities of £63.9bn; £51bn is currently outstanding, leaving a further £12.9bn (20%) of undrawn facilities
- 64% of the loans drawn were reported to be arranged at fixed rates of interest
- 93% of current loans drawn are repayable after five years
- The levels of unutilised security remain stable at £27.1bn (March £27bn).

The total new finance raised in the lending market during the year ending March 2011 was £0.5bn lower than in the year to 2010, a fall of 15% (Tenant Services Authority, 2011b, p. 3). A small number of associations have begun to explore funding sources outside of what might be termed conventional debt finance from lenders or via bond issuance. Partly this reflects gearing constraints but it is also aimed at achieving diversification of funding and exploring new funding sources. In the past few years a number of housing associations have used the private placement route whereby funds are raised directly from an investor and most recently we have seen the issuance of an unsecured retail bond aimed at individual investors. Given the contraction of debt

⁹ The survey is undertaken by TSA on each quarter to establish the levels of exposure to the risks faced by the housing association sector. In the June survey, 276 responses were received from larger housing associations owning/managing more than 1,000 homes.

¹⁰ Around 85% of all housing association private finance are supplied by Lloyds Banking group, Barclays, Nationwide, Santander and Royal Bank of Scotland (Heywood, 2010).

finance provision (and debates about costs and terms) from the mainstream lenders it is likely that these other avenues will grow in popularity.

5.3 Rents

Rents for general needs housing are regulated. The current regime – in place until 2015 – allows rents to rise by the retail prices index (RPI) plus 0.5% per annum – implying a rent increase of up to 6.1% in 2012/13. While this has on occasion caused problems for individual housing associations, the regime does provide stability and predictability to the income stream for housing associations. This in turn has made long-term business planning easier and has facilitated meeting loan covenants and calculating asset values for loan security purposes.

Rental receipts on general-needs housing make up 79% of total housing association income. The stability of this income is underpinned by housing benefit, which contributes around 70% of general-needs rents and is paid by government direct to landlords in respect of tenants on low incomes (Heywood, 2010).

Current reforms include the removal of the housing support element of Universal Credit paid directly to landlords not just in the private rented sector but also for social tenants. At the same time the introduction of overall caps on welfare benefits and reductions in rent for those under-occupying rented housing removes some of the comfort to lenders that has been offered by the present housing benefit regime. Bond investors in particular place strong reliance on the current social housing rent formula and its effective link to RPI (Heywood, 2010).

5.4 The Affordable Rent regime

From 2012/13 onwards, new supply will be highly dependent on whether the new Affordable Rent model works (HCA, 2011). The £1.8bn Affordable Rent programme allows social landlords to charge rents at up to a maximum of 80% of market level, with the increased rental income intended to attract private finance and fund the development of new social homes. To boost output and enable transfers, providers will also be allowed to convert existing relets from standard rents to the higher affordable rents. The extra income will cross-subsidise the new development.

In London and most parts of southern England, raising rents to 80% of market level would close much of the funding gap, but affordability of higher rents has to be considered (*Social Housing Magazine*, 2011b) – especially for family-sized homes. This is particularly an issue for those on benefits because of the government's proposed overall benefit cap (£26,000 p.a.) to be incorporated in the Universal Credit regime from 2013. There are also some areas where 80% of market rent runs very close to local housing allowance (LHA) levels (the 30th percentile of rents in the broad market rental area), which the government has made clear it does not expect social rents to exceed. Consequently, in their funding bids, some housing associations have consciously capped affordable rents at well below 80% of market levels. In London the average increase is estimated at around 60–65% with rents close to social target rents for family housing and higher ratios for smaller units. In effect, these housing associations are

giving up some of their potential capacity to build new homes to reduce the impact of the higher rents on tenants (Pawson and Wilcox, 2011).

Conversely, in many parts of the North and the Midlands, even the application of the full 80% of market rent policy would leave a substantial shortfall in development finance once the reduction in grant funding is taken into account. This is because market rents are not so high and social target rents are often already close to or above the 80% mark. In addition, a significant part of the existing social housing stock has a lower market rental value than much of the private market (*Social Housing Magazine*, 2011c).

Whether the new model will generate affordable housing output on the scale officially envisaged is very difficult to predict. Apart from decisions on rent levels, it depends crucially on how far providers 'convert' existing relets. Modelling by the Federation and others suggest that the estimates are relatively conservative and that there is further potential. Moreover there were many offers which were not accepted by the HCA. However, assuming a 50% 'conversion rate' and allowing for many other factors, Hometrack suggests that the new regime might generate fewer than 50,000 homes in the period to 2015 – well short of the 80,000 required to meet ministers' targets. If just 25% of relets were converted, output would shrink to below 22,000 over the period.¹¹

On the other hand, the affordable rent scheme may encourage private landlords to provide social housing. Grainger, the UK's largest listed residential landlord which owns or manages more than 40,000 homes in Britain and Germany, is looking at creating a housing association arm. The £133.8m-turnover company, which has more than £2bn of property assets, believes the move to affordable rents at up to 80% of market rent brings the housing association tenure closer to that of the regulated private rented sector tenancies which it manages.¹² Grainger has 6,472 regulated tenancies, which is 58% of its UK portfolio and all of those have rents of between 60% and 70% of market rent (*Inside Housing*, 2011).

Much of the programme to 2015 is already in the pipeline. Even so, the risks associated with the operation of the Affordable Rent regime are many. They include the possibility that private development will be restricted to the point where affordable housing also cannot be delivered – especially if there is a stronger than expected economic downturn; planning and other problems associated with local authority attitudes to the Affordable Rent regime (possibly concentrated in London); problems in delivering intermediate ownership in the context of the new regulatory regime and continued constraints on mortgage funding; greater difficulties in borrowing because of increased risks to the rental stream as a result of welfare changes; as well as issues of adjustment and delay associated with the timing of delivery and how it matches to subsidy. If these problems were to result in lower than projected output levels, it would still be possible to realise many of the opportunities in the future.

There is more concern about the sustainability of the affordable rent regime without significant grant after 2015. The regime is debt hungry and many associations will reach

¹¹ Affordable rent policy impact analysis, dated 1 April 2011. <http://hometrack.re-hosting.net/our-insight/commentary-and-analysis/affordable-rent-policy-impact-analysis>

¹² Grainger gives its tenants a regulated tenancy which allows them to stay in the property for the rest of their lives. The rent is set independently and is less than the rate for similar market let properties. <http://www.graingerplc.co.uk/regulated.asp>

their borrowing limits, especially if house prices are falling. Even so, many other associations, especially in the South, will have continuing opportunities – and will have gained experience about how to implement the regime effectively over the coming years.

5.5 Cross-subsidy

The decrease in the level of Social Housing Grant makes housing associations more reliant on cross-subsidy for their development projects. There are many examples of cross-subsidy models:

- S106 contributions from the developers of private homes on sites being used for affordable housing
- Shared ownership 'staircasing' receipts
- Proceeds from the market sale of existing housing association properties
- Proceeds from rents charged across the stock
- Uplift in the value of homes so more can be borrowed.

Cross-subsidy still offers significant potential to deliver affordable housing at reduced cost, or no cost, to the public purse, and in ways which also favour good design and the provision of housing and in many cases without obvious physical distinctions between rented or owner-occupied housing. Its weakness is that cross-subsidy has to be extracted in some way and it is subject to market conditions both in terms of its value and the ease of extraction.

5.6 Cross-subsidy from shared ownership

Shared ownership has been the predominant form of market development for housing associations for many years. Profits from shared ownership can be used to 'cross-subsidise' social rented (general-needs) housing. Since the banking crisis, shared ownership has become a less viable option with problems over mortgage availability for purchasers and with falling prices making cross-subsidy problematic. The numbers of new-build shared ownership units have dropped significantly.

The latest Quarterly Survey of HAs: June 2011 (Tenant Services Authority, 2011b) reports that LCHO sales have steadied recently. The stock of unsold LCHO units decreased progressively each quarter until April 2011 when there was an 8% increase to over 4,100 units. The number of LCHO homes which were unsold at the end of the quarter fell by 3.5% to 3,985 (in March there were 4,131). The number of LCHO homes which were unsold for at least six months remains stable at 30% of total LCHO sales (March, 29%).

The average proceeds gained from each sale has fluctuated significantly. In late 2009, the average proceeds had fallen from over £80,000 to £62,000. After peaking at £88,000 in the quarter to March 2010, average proceeds have fallen every quarter since to £72,000. These reductions in proceeds feed through into reduced cash flow and increased working capital funding requirements, as well as reducing the amount of surplus available to support other activities. Overall, the LCHO programme appears to

have stabilised to a more sustainable forecast development level of around 8,000 per annum.

5.7 Future funding requirements

The Tenant Services Authority forecast that housing associations would require £20bn of additional private finance over the five years to 2013–14, or roughly £4bn a year. They predict that 25 to 50% of this (£5–10bn) could be raised in the capital markets (Heywood, 2010). Recent evidence suggests that debt finance will not be available on 25-year loan terms and that debt funding will be concentrated in the 0–5 years span with long-term finance being raised in the bond market. This is a significant shift and if this is what happens then housing associations will have to think much more carefully about their treasury strategies and put much more work into managing their funding needs. It does expose associations to a level of funding risk from which they have been insulated to some degree in the past.

5.8 The European Investment Bank (EIB)

In this context the EIB is important. It is the European Union's long-term lending bank and is owned by the member nations of the European Community (the UK Government is one of the four joint largest shareholders with a 14% holding). It can be considered as a typical intermediary between the financial market and the financing of activities of general interest that the market does not finance or finances only partially. The EIB has invested in areas of activity such as the environment, sustainable development, urban development and social housing.

Recent EIB investments in European social housing include:

- The provision of €125m to finance the construction of 12,000 social homes to be rented for 10 years, 25 years, and 10 years with the right to buy in Catalonia, Spain.¹³
- With the counterpart Vlaamse Maatschappij voor Sociaal Wonen, a centralised public funding vehicle, the EIB provided loans for the financing of the years 2010 and 2011 of the multi-annual regional investment programme involving the demolition, modernisation, rehabilitation and new construction of social housing. The programme was implemented throughout the Flanders region (population: 6.2m) in Belgium by local social housing associations, whose activity is supervised and monitored by the Inspection Agency of the Flemish Region.¹⁴

¹³ 'Spain: EIB supports social housing in Catalonia with EUR 125 million', 14 June 2011 <http://www.eib.org/projects/press/2011/2011-080-espana-el-bei-apoya-vivienda-prottegida-en-cataluna-con-125-millones-de-euros.htm>

¹⁴ Flanders Urban Social Housing, 17 September 2010 <http://www.eib.org/projects/pipeline/2010/20100345.htm>

- The provision of €125m to the Caisses d'Épargne for social housing loans to build and upgrade social housing in France.¹⁵

The EIB has provided funding for UK housing regeneration since 1998. Whilst the EIB operates in its own right in relation to very large regeneration schemes, it also provides funding through a third party intermediary, the Housing Finance Corporation (THFC), for investment in 'smaller' housing regeneration schemes with a total cost of less than €50m. As a not-for-profit organisation, THFC¹⁶ (founded in 1987 through a joint initiative of the Government, the Housing Corporation and the National Housing Federation) passes on the EIB money at cost and does not charge a margin, which is a substantial advantage to housing associations.

Recent EIB investments in UK social housing include:

- EIB's £100m loan in 2008 used to increase the number of available housing units, enhance energy efficiency, improve health conditions for tenants and alleviate unemployment-related problems. About 50 schemes have already been identified as benefiting from this loan.¹⁷
- EIB provided a £95m (approx. €107m) loan to Triathlon Homes for the development of accommodation for athletes at the London 2012 Olympic and Paralympic Games, under the auspices of the Olympic Delivery Authority (ODA). Over 1,300 athletes' flats will be converted into social housing units after 2012 as part of the overall Games legacy.¹⁸
- Another £345m of EIB funding was provided to 35 UK housing associations through the Housing Finance Corporation. The funds will be used for regeneration-focused projects. English HAs received the largest slice of the total sum, at £150m (*Social Housing Magazine*, 2010).

5.9 Welfare reform

Housing associations, like other landlords, benefit from the personal subsidies paid to tenants via housing benefit (HB). Over the decades since private finance was introduced housing benefit has come under strain and is now facing a real threat. The Department for Work and Pensions has implemented significant cuts in housing benefit which include caps on the maximum assistance available and a less generous local housing allowance in the private rented sector.

¹⁵ 'EIB to provide EUR 125 million to Caisses d'Épargne to fund social housing', 15 September 2009.

<http://www.eib.org/projects/press/2009/2009-176-france-125-millions-deuros-de-la-bei-en-partenariat-avec-les-caisses-depargne-pour-financer-le-logement-social.htm>

¹⁶ Established in 1987 through a joint initiative of the Government, the Housing Corporation and the National Housing Federation, THFC obtains fund from bond issues (public issuance and private placements) and bank loans including funding from the EIB.

¹⁷ 'UK social housing receives welcome finance boost from EIB', 14 November 2008.

<http://www.eib.org/projects/press/2008/2008-108-uk-social-housing-receives-welcome-finance-boost-from-eib.htm>

¹⁸ 'EIB promotes social and affordable housing in the UK: GBP 95 m loan for London Athletes' Village', 24 June 2009
<http://www.eib.org/projects/press/2009/2009-120-eib-promotes-social-and-affordable-housing-in-the-uk.htm>

In simple terms the welfare changes most likely to affect housing associations are:

- The bedroom penalty will affect 670,000 working-age households in the social sector, rising to 760,000.
- The non-dependent allowance, which is the deduction for an adult child deemed to be in a position to contribute to the rent, is being increased to up to £69 a week.
- Absolute rent caps in the private rented sector, which vary by number of bedrooms and which will rule out the use of the private rented sector in the most expensive areas.
- Rent increases linked to increases in RPI / CPI in the private rented sector which will start to be phased in for new tenancies in 2013 and for existing tenancies in 2014. A cap will be set on the maximum total benefit payable of around £500 a week (£350 for childless households). Rental payments for households affected may take lower priority than other necessities of life. The shared room rate is currently set at the level that assumes a single person under 25 is sharing with others. The age limit is to rise to under 35. Most such households live in bedsits or one-bed flats and so unless they move they will face a further reduction in benefit.

The Government is also planning to subsume housing benefit into a new Universal Credit. Universal Credit will replace working tax credits, child tax credits, housing benefit, income support, and the income-related jobseeker's allowance and employment and support allowance. It is not at present proposed to include council tax benefit.

As part of the move to Universal Credit, the government is piloting direct payment of the housing benefit element to tenants in order to encourage them to manage their finances. There are concerns that this may lead to increased rent arrears as households unused to managing their own finances get into difficulties. This may be a short-term effect, as households may get their finances in order, possibly with help from financial advisors or their landlords. However there are costs to landlords in providing these services and possibly in terms of loan conditions.

If rent arrears remain high lenders may be increasingly wary of providing capital funding on the basis of future rental streams and / or may increase the costs of such capital, creating further difficulties for associations.

The cap on the maximum total benefit payable will be particularly hard-hitting for larger families in areas of high housing costs. The cap which applies to households across all tenures receiving welfare benefits may be more restrictive for households affected than the local housing allowance caps being introduced for private sector tenants, and in high-value areas it also cuts across the new regime for 'affordable rents' for new social housing. For very large families, the cap could even affect their ability to meet current social sector rents.

The Federation has produced some estimates of the cost of welfare reforms (National Housing Federation, 2011). This suggests that the total potential cost to housing association tenants will be £369m in 2013/14, rising to £374m in 2015/16. The total estimated cost to housing association landlords is £224m in 2013/14, rising to £434m in 2014/15. The two estimates have been calculated independently with different

assumptions for tenants and landlords, therefore they cannot be added together to estimate a combined impact. But they provide a sense of the scale of the likely impact of the reforms.

The impacts will vary across the country. For example, not only is the welfare cap at present expected to be fixed in absolute terms across the country, the bedroom penalty is a fixed percentage of rent, so high rent areas will see the highest cuts. Social – and indeed private – landlords in parts of London will be hit the hardest, as will large families in the most pressured areas.

Discussion questions:

- *Would an investment model similar to the affordable rent regime be sustainable beyond 2015?*
- *What are your views on a revenue versus a capital investment model?*
- *Should housing associations have freedom over what rents they charge or should they continue to be set by the government?*
- *How can we ensure the future financial viability of housing associations?*
- *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

Summary:

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.

As this report has made clear, the scale of unmet housing requirements is daunting, particularly in the context of diminished grant funding. Although the recently published housing strategy *Laying the Foundations: A Housing strategy for England* does offer some modest new funding streams, it is quite clear that the Government expects the market to provide much of what is required. In that context the search for funds and for effective models of financing becomes very important.

As part of the work to produce this background report we surveyed the spectrum of funding models that exist, are planned or are in discussion. As is evident from Table 14 and the Appendix (which covers both the UK and international experience) there are a

wide variety of models now in place or under construction through which housing associations might either fund or get access to funds for new development.

These models fall into at least six main categories. Those we have identified include:

- The use of government grant in the form of the New Homes Bonus and possibly some remaining capital grants
- The use of tax and planning gain funds and possible tax breaks including CIL, S106 and possibly TIF and REITS
- Guarantees to lower the cost of funds – from local government and possibly housing associations themselves for LCHO
- Restructuring payments – including ‘Buy Now Pay Later’ for public land and, in the past, PFI
- Equity involvement through restructuring past government grant into equity; community land ownership; public/private partnerships involving public land; the transfer of assets into REITs, the possible use of SIPs and other pension funds; and ultimately the privatisation of parts (or possibly all) housing associations; and
- Increased access to different debt funding sources, including greater use of both wholesale and retail bond markets.

Of particular importance when assessing the potential capacity is to clarify: the extent to which funds can be recycled to enable programme to be maintained; the extent to which there are existing funds available which are not being effectively recycled; and the possibility of selling assets to enable higher levels of new building.

In the first context there are a number of models that aim to build up revolving land bank funds based on the New Homes Bonus, CIL and other sources of funds available to local government which can be used to purchase land.

The most important element in existing funding which is not directly supporting additional borrowing is the past grant (which is currently classified as a subordinated loan). Were this to be transformed into equity this some suggest it would provide a stronger asset base and enable additional borrowing for new investment. A related issue is the potential for partnership between associations and indeed local authorities with plenty of capacity to borrow with those with the appetite for development.

The traditional approach to selling assets is through build for sale in investment – which enables funds to be recycled for additional investment once the property has been fully or partially sold. Selling high-valued stock also has potential, including the possibility of some form of Right to Buy. Potentially the biggest opportunity might come through the use of REITS, which in principle would allow some housing associations to transfer affordable rent stock into a REIT and recycle the sale value.

In practice the most useful sources of funds in the shorter term will come from the continuing use of debt finance – where housing associations are fishing from the same

pool as many other sectors. Over time, however, some of the opportunities identified could generate significant opportunities although usually at the cost of the loss of traditional social rented housing.

Table 14 addresses the strengths and weaknesses of some of the models that have the greatest chance of success. The Appendix provides more detail of these and other models as well as information on models found in other countries.

Table 14: 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 RLB 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 HA /LA 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 5 s106 payments for infrastructure
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
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 PFI	Only applicable to local authorities with a decent estate portfolio; complex and expensive to set up

There are strengths and weaknesses with all the models set out in the table. 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, such as the New Homes Bonus, the Community Infrastructure Levy and REITs. 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. The use of S106 has also served housing associations well, although concerns remain about output in current housing market conditions, especially once CIL takes over infrastructure funding. Equally traditional forms of debt finance, including bonds, have proved good value for money and should continue to do so. However the interest rates required have risen significantly and the depth of the market is unclear.

6.1 The implications for housing associations

Certain government mechanisms are likely to continue to be important for all developing housing associations, including S106 for affordable housing, CIL for necessary infrastructure and the New Homes Bonus especially if local authorities use the grants to create revolving land bank funds, which have been very successful in Scotland.

Loan guarantees may become increasingly important, since they enable access to cheaper finance as the local authority bears some of the risk. Housing associations may also use guarantees to other parties, for example to support the sale of properties built for sale.

Although REITS have never really taken off for housing, the changes in the Finance Bill may make it easier for housing associations to transfer some of their properties into REITs to be sold to institutions. However, the issues associated with past government grant and charitable status may make the process too complicated at least in the shorter term.

For large associations, the following mechanisms are promising:

- Special Purpose Vehicles to obtain large-scale investment
- Joint Ventures with private developers to do the same

Tax Increment Funding or Accelerated Development Zones as they are called in the UK are promising longer-term approaches for large-scale regeneration – and again the Finance Bill has made useful improvements to the framework.

For all housing associations, greater investment by the institutions such as pension funds and life insurance companies, and indeed individual pension arrangements under SIPP, could become increasingly important as affordable rents become the norm and rental rates of return improve.

Also with the introduction of affordable rents, mechanisms such as Sale and Leaseback could become more important, especially for larger associations. They have long been the norm in large commercial property developments.

For small associations the possibility of cheap loans from the Charity Bank or the Triodos ethical bank may become increasingly important – although the Charity Bank has not invested very much in housing to date. There are limits on the size of loan to any individual organisation so these avenues are really only for small schemes.

Up to now, Community Land Trusts have only been important on a small scale in rural areas. They are unlikely to become more common unless there is a major government boost – as was envisaged in the form of Local Housing Companies at the time of the 2010 election.

For developing associations that have invested in shared ownership, a larger second-hand market could be important, provided they include clauses in new leases to ensure first refusal, and then actually take these up. There is a small second-hand market in London, but it would need a boost by associations to ensure that shared ownership homes are recycled when purchasers move on.

6.2 The implications for the sector as a whole

This review of financing mechanisms has shown that there is a range of approaches that could be used more widely throughout the sector. However, not all approaches will suit all housing associations. The most important factors to take into account when developing a policy in this regard include:

- Current levels of indebtedness and therefore the organisation's capacity to increase borrowing when opportunities arise
- The size of the organisation – as many of the better-value debt financing and indeed equity schemes can better be undertaken at scale
- The gap between social rents and market rents in the organisation's areas of activity – as this determines the extent to which the organisation can benefit from the affordable rent regime
- Experience with partnerships with local authorities and indeed other housing associations – as many of the proposals, especially those involving public land, will require often sophisticated joint ventures
- The ethos of the organisation – in particular whether it emphasises the need to maintain provision of traditional social rented housing or whether it is looking to expand into intermediate and indeed market housing.

From the point of view of the sector as a whole it is clear that there is capacity to undertake large-scale development if the conditions are right. However the majority 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. Some of the most important implications are listed below.

- If associations wish to take up opportunities as currently envisaged this may involve a significant change in ethos for some organisations.
- Taking on large-scale development will involve greater risks and will require sophisticated management skills.
- It is difficult to see any means of adding significantly to social rented housing unless capital grant in some form can be retained.
- Many housing associations may not wish to expand in this way – and will be unable to use their assets to support development of affordable housing on a significant scale unless other forms of partnership can be developed.
- Most of the larger-scale opportunities will involve some government support – ranging from modification of existing regulations, clarification of the position of past capital grant, the possibility of limited guarantees to outright grant.
- The range and complexity of possibilities, while offering opportunities, is unlikely to provide large-scale finance and development in the short term. Rather these models are part of a longer-run evolution to a self-sustaining sector capable of using its own – and other – assets to enable growth.

Discussion questions:

- *What is the potential of alternative development and funding models to help support the delivery of new homes?*
- *What barriers are there to these models that need to be addressed?*
- *Are there other potential models that we should consider?*

Conclusion

The breadth of the evidence base and other background information presented in this document are indicative of the number of factors that influence the funding of future homes. They are often complex and inter-related but need to be holistically analysed when considering the shape and design of future investment in new homes.

Clearly, different factors will weigh differently for organisations depending on the geography that they operate in, their strategic goals and financial capacity and strength. There is, however, a window of opportunity for the sector and its stakeholders to influence the shape and make-up of future investment in building new affordable homes.

The National Housing Federation is embarking on a wide-ranging discussion with housing associations and our stakeholders to gather views of what the future may look like. We're keen that as many organisations as possible take the opportunity to participate in this important piece of work.

Further details of regional consultation events can be found on our website. Alternatively, if you have any questions about this project or want to express your views or ideas in writing, please email Lucy Thornycroft, Investment Leader, lucy.thornycroft@housing.org.uk

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