Freedom to succeed:
liberating the potential of housing associations

Housing associations face fundamental challenges to their role in the housing market and how it might be funded – the greatest challenges in 40 years. The sector has the appetite to do more to resolve the housing crisis, but the level of income and funding uncertainty in the current policy and financial environment could limit potential investment and the capacity to achieve the volume of housing output needed.

Against this background, in late 2011 the Housing Futures Network commissioned the University of Cambridge Centre for Housing and Planning Research (CCHPR) to review the future of social housing and housing associations considering in particular, the role of social housing and new ideas around future funding. This brief summary report presents our main conclusions.

To enable housing associations to deliver more, the government should:

- recognise the growing and necessary diversity of housing associations in terms of client groups and funding mechanisms and establish a policy and regulatory framework that emphasises freedom from central controls and supports pluralist solutions and maximum flexibility
- commission an independent assessment of Affordable Rent – its longer-term sustainability and capacity to produce homes and cross-subsidy
- consider the case for a modest, general, one-off rent increase across the entire social housing sector, as an alternative to the two tier system being created by Affordable Rent
- at the same time, confirm that regulated rents may continue to be increased at RPI + 0.5%
- conduct a full examination of the consequences, merits and opportunities that may be presented by converting housing grant into equity
- produce a clear response to the social housing REIT consultation with a view to bringing forward proposals for adoption in 2013/14; resolve the informal consultation on PFI swiftly; and explore the possible application of the new loan guarantee scheme to the affordable housing sector
- provide certainty that the link between actual rents and the housing element of Universal Credit will be retained in the long-term
- carry out a detailed assessment of market and affordable housing requirements in England to 2031 and the different funding mechanisms needed to meet them
- resolve the current tensions between the direction of central government policies on housing funding and what local government deems acceptable in different localities.

Increasing housing supply is an efficient way of generating economic growth. It helps meet and satisfy high levels of housing need and demand, creates jobs, supports consumer spending, and reduces social and political tensions. Rather than acting as a brake on recovery, housing should be used to stimulate the economy.

Housing associations are willing providers. With the right frameworks in place, we can generate and commit the capacity and resources to make a significant contribution to meeting England's housing needs.

Social housing is changing and diversifying

The fundamental role of social housing has been to provide housing at below market rents to those who cannot afford to pay market prices.

But the new Affordable Rent regime significantly reduces the price variation between the affordable rented sector and the private rented sector. The income overlap between those housed in the two sectors will be more evident by 2015, especially among people of working age, as the proportion of Affordable Rent homes grows. Provision at social rents will be dominated by supported and older people's housing.

The government's evaluation assumes that most households moving into Affordable Rent homes will come from the private rented sector. But in 2010/11 only a quarter of new social housing tenants were from the private rented sector (PRS) and nearly 40% were previously living with friends or family. If this pattern is replicated under Affordable Rent it will have major implications for Housing Benefit.

How this may evolve is not yet clear, but a two tier system of rents and customers could well result. In any event, the bulk of housing association income will almost certainly come from benefit-dependent tenants for the foreseeable future.

Economic theory suggests demand side subsidies are more appropriate to well operating markets. However, in a poorly operating market, with an economy struggling to recover, and in an environment of rising rents, demand subsidy requirements can increase quickly as a result of supply constraints, growing unemployment, greater housing need, and bigger disincentives to work.

Yet the government is actively seeking to reduce the welfare benefits bill, including Housing Benefit, through a series of fundamental reforms with significant financial and housing consequences for hundreds of thousands of households. The danger of a serious mismatch between policy intentions and economic realities is manifest.

With living standards under real pressure, rising unemployment among young and traditionally lower income households, and reductions in welfare benefits, it is also questionable whether tenants will be able to afford the higher rents needed to cross-subsidise more social housing provision, and there is a clear potential for a variety of unintended and adverse social consequences.

Housing associations are inevitably having to adapt to manage the uncertainties these economic and policy changes are creating. The new investment regime presents some opportunities to grow financial capacity, but the route to unlocking resources is more complex, requiring much greater innovation and diversity of approach. Differing levels of assistance and differing products are needed to meet a broad range of needs in differing circumstances.

Unlocking new investment options

The quantity of new housing that Affordable Rents might produce is very uncertain. The capacity to deliver new supply is dependent on increasing rents, but the ability to raise rents will vary markedly between different areas.

Levels of grant, discounted public land, S.106 contributions, opportunities for cost efficiencies, stock rationalisations, better design approaches and other factors could all impact on the volume of homes produced in different places.

Lenders are also likely to prove conservative in their response, reflecting growing indebtedness and higher risks. Interest rates on loans will reflect lender views of market conditions and the security of rental streams.

Overall, Affordable Rent is unlikely to increase borrowing capacity in direct proportion to the percentage increase in rents. However, other financing options do exist. The potential for bringing institutional investors into the market remains important; and some local authorities, particularly larger ones, should invest directly in housing provision using the new freedoms at their disposal.

Clearly, alternative investment models to Affordable Rent are also possible and should be considered for the future. For example, raising all social rents by a relatively modest amount could prove a more sustainable long-term model, avoid the social contradictions and tensions likely to be generated by a two tier rents system, and open up the possibility of introducing equity investment.

Detailed exploration of how the value of historic grant on housing association balance sheets might be unlocked and used is also now vitally important. Potentially, around £35 billion of grant could be recycled in some way. One mechanism could be to redesignate existing grant as an unsecured liability. It could then be turned into an equity investment with an income stream derived from higher rents providing a return to the investor.

If a track record for servicing equity investment could be established, housing associations could then raise further equity finance in the market to fund new development Inevitably, some housing associations will find working with equity in this way more attractive than others.

None of the more obvious options to increase capacity is simple. There are issues to resolve with them all. Yet, taken together, they could generate sufficient capacity to fund a large development programme. Carried out in partnerships between the main players, risks could be shared and capacity further enhanced. This has the potential to create a sustainable long-run increase in housing output.

Future approaches

Economic and financial circumstances for at least the medium-term dictate that future solutions to housing supply will be pluralistic.

A 'one size fits all policy' framework and continuing financial uncertainties can only make it more difficult to deliver higher volumes of affordable homes.

Housing associations can do more with the capacity at their disposal, but doing more in the current situation means they will need to seek diverse funding models for diverse circumstances. Longer-term certainty over income streams, and particularly a retained and solid link between real rents and Housing Benefit payments, is also crucial in maintaining confidence to invest.

The Homes and Communities Agency should be alive to the need for different regulatory deals for providers making different market offers, especially around rents. A flexible regulatory approach also offers the possibility of being able to devise a solution to the 'deadweight' cost of some housing associations not using increased rental income to fund development.

In summary

A number of new funding options have real potential. Grant write off or conversion to equity needs to be fully evaluated to clarify when, where and if it works. A social housing Real Estate Investment Trust and changes to the structure of REITS could be an important addition to the armoury, and the Treasury's work on this should be taken forward urgently if new structures are to be available by 2015.

The likely impacts of other mooted options, such as a revised PFI and Tax Increment Financing, need proper evaluation as quickly as possible. Recently announced City Deals offer a tangible opportunity to test their effectiveness.

Housing grant will also continue to be an important part of the affordable housing mix. Indeed, given the apparent complexity of most alternatives and the rising benefit costs from higher demand side subsidy requirements, the direct grant, mixed funding regime looks a model of simplicity and certainty and retains many attractions in terms of its capacity to get new homes on the ground.

Beyond this, local authorities have a key role to play in helping maximise supply. Not only using the investment potential of self-financing and initiatives like New Homes Bonus, but by building public-private partnerships, using their public land as a subsidy, understanding and accepting the economic realities attached to Affordable Rent levels, and ensuring S.106 obligations (responsible for around 50% of new affordable housing development in recent years) are retained as an important creator and driver of cross-subsidy. Councils would also be able to do more if UK definitions of public expenditure were brought into line with international standards.

All this serves to emphasise that national government retains a key role in setting the rules and policy agendas that ultimately govern how the market will work. To achieve its goal of driving up housing supply, government must engage more intently with providers and enablers in ensuring suitable investment models can flourish. Government strategy needs to recognise and support the multiplicity of funding solutions that are likely to come forward.

Details correct at time of print, July 2012
RHFN9/056-0712V1.0E

More information

For more information please contact:

David Mills
Places for People
0207 843 3800
david.mills@placesforpeople.co.uk

Hugh Owen
Riverside
0845 111 0000
hugh.owen@riverside.org.uk

Hilary Burkitt
Affinity Sutton
0300 100 0303
hilary.burkitt@affinitysutton.com

John Walker
Gentoo Group
0191 525 5000
john.walker@gentoogroup.com