A new settlement between government and independent housing associations

Policy Exchange

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About the Author

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Introduction

The current relationship between the Government and the housing association sector has seen better days. From the point the Conservative party announced its intention to extend the Right to Buy to housing association tenants in April 2015, to the social rent reductions in the following summer Budget, there have been palpable tensions. Matters improved following the introduction of the Housing and Planning Bill in the Autumn 2015 with the voluntary agreement between the Government and sector to extend the Right to Buy to housing association tenants – Voluntary Right to Buy (VRTB).

This report is written on the premise that housing policy outcomes could be much improved by a new and more constructive relationship between Government and the sector, following in the footsteps of the VRTB agreement. This is the idea behind the 'New Settlement'. There is a strong commonality of Government and housing association interest: to build more homes to meet housing need and offer greater homeownership opportunities to current housing association tenants to support aspiration – intertwined with supporting the independence of affordable housing tenants.

The Government and the sector itself are grappling with a number of problems around how best to reshape the sector to achieve these things. A New Settlement is partly about hitting the reset button to usher in a new, more grown up, relationship between Government and housing associations longer term, one of housing association responsibilities, incentivised benefits, and self-regulation. But such a new relationship is only a means to an end – it is ultimately about supporting the shared, outcome-based, objectives of building more homes and extending homeownership.

The housing association sector is diverse but providing homes for those in housing need is the cornerstone of any housing association, no matter how big or small. There are many facets of housing need – building homes to address unmet need, providing decent housing with emphasis on quality as well as quantity, and housing that is equipped for those with special support or care needs. It is easy to forget that Government's emphasis has not always been on building homes. Even recently, billions of pounds were being spent by the Government and housing associations on the Decent Homes Programme, which ran from 2000 to 2015, to bring the social housing stock up to the Decent Homes Standard. But the nation's housing crisis and the acute shortage of housing has increasingly seen a political narrative where the emphasis is placed squarely on the need for housing associations to build more housing.

Not all housing associations believe that they should be building more homes and some don't consider themselves to be in the position to. Most housing associations are Charitable Registered Societies (Industrial Provident Societies pre -2014). They are formed for the benefit of the community and in their rules the provision of housing is not always explicitly or extensively about building new housing. So for them, housing is not just about numbers but community and stability. This can mean some housing associations are inherently oriented more towards looking after their existing tenants and providing good services for them, rather than building new housing for those on housing waiting lists. Some local authorities also have fewer people on their waiting lists than others do.

Invariably, housing associations assert they are *independent* private sector organisations. However, many housing associations feel very strongly that they, and the sector as a whole, should be building as many homes as possible to meet housing need, and that all but the very smallest housing associations (e.g. Almshouses) across the sector should be pulling their weight and 'sweating their assets'. They look positively and ambitiously to a future that sees them as landlords *and house builders* in equal measure, as well as to provide a helping hand to those on lower incomes.

Some housing associations that want to build much more are frustrated that Government treats the sector as one. The reality is that the Government treats the sector as one when applying the regulatory policy tool. This sentiment has grown during the last decade as each Government has increasingly taken a directive 'one size fits all' approach through regulation to try to get 'the sector' to do what it wants.

The downside of a one size fits all approach is illustrated by reference to the 4-year 1% social rent reduction policy. This was designed to target inefficient organisations by putting the squeeze on them (as well as save Housing Benefit money). Given social rents are around 90% of a housing association's income, a reduction in income clearly means most organisations have to make efficiencies or, if they cannot operate, exit the sector (through a merger or an amalgamation). But the flipside is a reduction in the amount of money that other housing associations – those that really want to build more, some already very efficient - can borrow to build.

This report argues there is a better way than regulation to get the outcomes that both these housing associations and the Government wants a large number of housing associations want a New Settlement that underpins an improved relationship with Government, a relationship that allows them the freedoms to do what they do best – prioritise house building, deliver a good efficient landlord service, support homeownership aspiration for tenants 'who can', as well as provide the vital housing support for those who can't. These are not, it is argued, mutually exclusive.

The idea of the New Settlement is a new 'City Deal' type of framework, with a number of voluntary deals called 'Housing Deals', negotiated between Government (either National or Devolved) and individual housing associations. These time-limited deals, renegotiated perhaps every 5 years, would give the housing associations signing up to them access to investments, freedoms and flexibilities. But housing associations would in turn have to deliver on a set of <u>outcome-based</u> commitments to the Government, reporting on progress against these in their audited annual reporting. Such commitments would necessarily include building a certain number of homes across a mix of tenures and extending homeownership to more existing social tenants. It is crucial that these commitments are outcome-based. A key aspect of the New Settlement is allowing partaking housing associations to deliver on outcome-based objectives *in the way they choose* – rather than being micro-managed by the Regulator as happens now. The New Settlement privileges could include loosening or ceasing certain regulatory requirements, additional government money and other financial support, and the ability of housing associations to set their own rents within a rent envelope agreed within their individual Housing Deal. In this way, it is hoped that these housing associations and the sector as a whole would be able to build many more homes.

Although initially the Government might offer housing deals only to a small number of housing associations to test the water, ultimately as many housing associations as possible need to sign up to them if the sector as a whole is to build the number of homes the nation requires. Housing associations not signing up to the New Settlement would continue to be regulated as they are now. The important deregulatory changes brought in by the Housing & Planning Act (2016) - for example allowing housing associations to dispose of (sell) their homes without the Regulator's consent - are welcome.

This report begins by setting out some important background and frames the rest of the paper. It is recommended reading especially for those with less knowledge of the sector. The main part of the paper is then split into three chapters around the key themes central to the policy debate – (1) more house building, (2) extending homeownership opportunities, and (3) sector consolidation. These chapters also contain the building blocks of the proposed Housing Deals in the New Settlement construct. The final chapter sets out what a Housing Deal could look like with an illustrative blueprint containing the recommendations for the key Government 'asks' of housing associations and for the key housing association 'asks' of Government to deliver on the objectives of the New Settlement.

Executive Summary

This report proposes a New Settlement between Government and independent housing associations to support the commonality of interest of Government and many housing associations. It is designed to facilitate a positive and constructive relationship between Government and partaking housing associations and, ultimately, to propose or recommend far better housing outcomes than the current regulatory framework does.

The proposed New Settlement construct is a set of voluntary Housing Deals between Government and individual housing associations, similar in concept to the City Deals. Each Housing Deal would be different but the Government – either National or Devolved - would control the number of Housing Deals it wanted, at least initially, to make the process manageable in terms of the logistics and to contain risk. Housing Deals also would be time-limited – perhaps to 5 years.

The recommendations contained in this report are the genetic make-up of the Housing Deals. They are designed to support the high level outcome-based objectives of the New Settlement, of (1) more house building (2) greater home ownership levels and (3) sector consolidation.

The recommendations are as follows.

More house building

- **Recommendation 1:** Housing Associations should commit to **a 3% to 4% building rate** for the duration of their Housing Deal, with the precise rate determined through their individual negotiation with the Government.

- **Recommendation 2:** Housing associations, in discussion with their commercial lenders, should over the course of time raise their debt levels to a prudent level, to finance additional house building – ' borrow to build'. A gearing level of 60% (borrowing at 60% LTV) on the basis of conservative current valuations, should be posited as a sector-wide prudential benchmark. 'Borrow to build' should be implicit, but integral, to most Housing Deals.

- **Recommendation 3:** Government should support housing associations to borrow to build by agreeing individual housing association **social rent envelopes that rise between 0 to CPI** (instead of -1%), determined through negotiation in their individual Housing Deal. It should also consider an extension of Affordable Housing Guarantees to enable borrowing cheaply.

Promoting homeownership

- **Recommendation 4:** Housing associations should offer their existing social tenants eligible for the Right to Buy or the Portable Right to Buy a new build home instead, to support an expanded 'house building for open market sale' programme, integral to each Housing Deal.

- **Recommendation 5:** Government and housing associations should agree a new **Voluntary Right to Part-Buy.** This would give a social tenant the right to buy a *share* of their home with exactly the same *percentage* discount as their Right to Buy.

- **Recommendation 6:** Government should compensate housing associations for the proposed **Voluntary Right to Part-Buy**, with the amount of compensation determined through negotiation within the individual Housing Deal. Full compensation is likely to be a red line for many housing associations in their negotiation.

- **Recommendation 7:** Government should introduce a new **Homeownership Allowance** for those exercising their Right to Buy or Right to Part Buy, payable for the first 2 years of homeowership, to help cover home maintenance and repair costs, at £15 a week. Housing associations *and councils* should offer maintenance / repair services to households at cost during the 2 year period, and a competitive local rate beyond.

- **Recommendation 8: Minimum 5 year fixed rate mortgage deals** for new Right to Buyers should be part of the eligibility criteria for the proposed Homeownership Allowance. Mortgage documentation would need to be provided as part of the application process.

Sector consolidation

- **Recommendation 9:** Almhouses and very small housing associations should be placed back under the auspices of the Charities Commission and removed from the Regulator's control.

- **Recommendation 10:** Only housing associations managing or owning a stock of 4,000 homes or more, or consortia / groups of smaller housing associations with a combined stock of 4,000 homes or more, should be eligible for a Housing Deal.

Background: the housing association debate

When it is distilled down, the housing association debate boils down to three key fundamental questions: what housing associations are for; what housing associations are –namely public or private sector; and, closely related, the nature of their relationship with Government (controlled/directed or independent). It is important to grasp these to fully understand the different sides of the debate.

B.1 What are housing associations for?

This is actually fairly simple at one level. Housing associations are for people in housing need[1]. The primary purpose of most housing associations is to provide homes for people on low incomes. This is set out in the rules (and constitution) of individual housing associations. The requirement for the stewardship of their homes and estates (i.e. landlord function) is an essential part of that. Increasing the supply of 'social housing' homes (i.e. building or home acquisition) is also, often, a part of a housing association's purpose, but not always explicit.

Housing associations have, in one form or another, been around for at least two centuries. Some of the more well-known traditional housing associations, such as Peabody Trust, were established out of philanthropic roots in the nineteenth century to provide housing and shelter for the working poor. Almhouses, that predated Peabody, were set up by local church groups and charities to provide housing for the 'deserving' poor. Trusts were often set up in the wills of wealthy individuals. They were always independent private sector organisations.

Today, housing need can be much more broadly defined as households unable to access the housing market because they have insufficient income. However, the housing crisis – a general shortage of housing that impacts affordability for those further and further up the income scale – means that housing need in this sense has never been greater. Housing associations cannot possibly cater for all of these. The more narrow definition of housing need is 'priority need'. Through the allocations system, allocates such households to social housing or places them on the local authority housing waiting list. Since they have been providers of "social housing", housing associations have shifted their provision of housing towards people in priority need[2] - the same purpose as council housing - but housing associations have traditionally provided housing for other household groups too, based on their own criteria / charitable objectives.

Housing associations have also provided housing not just for low income groups but also for vulnerable and disadvantaged people, including those with additional care and support needs, for example, the elderly and infirm, those with severe learning difficulties, and those with other disabilities that may prevent them from working, as well as homeless people including those with drug and alcohol problems. It is

1 The difficulty is that 'need' is a subjective concept and can be defined in many ways.

2 For e.g. a homeless household with children is a priority need category, as is a homeless elderly household

important therefore, to understand the distinction between "general needs housing" and "supported housing". Housing associations own and manage 2.6 million homes of which around 2 million are general needs housing (for low income households) and 0.6 million are supported housing (for low income households with additional care and support needs), including, specialist housing for older people[3].

Providing housing for people in need is largely non contentious. But many housing associations, including those with strong home building records, are also involved in other activities. These activities are not always tangibly linked to meeting housing need, such as help and support for disadvantaged housing association households getting into work and wider employment services. This has been a traditional function of housing associations even before the Welfare State.

Many housing associations are also engaged in community support. But this could mean almost anything, which says less about whether it is a worthwhile activity and more about transparency. It isn't always black and white. Sometimes housing associations feel compelled to do the things that perhaps they would rather not have to. One former housing association CEO, interviewed for this report talked about antisocial behaviour as having been the second most common complaint of his tenants. His housing association spent a lot of money trying to address it. He remarked "A housing association [should] have nothing to do with [dealing with] antisocial behaviour. Antisocial behaviour is what the police are for".

There is much debate within the sector as well as with Government about how much money housing associations should be spending on these things, given they consume limited and valuable housing association resources that could otherwise be spent on building new homes. The perception of lack of transparency and clarity about how some of the money is spent also grates with Government because it believes such spending is off the back of large net rental surpluses largely derived from Government money – namely Government spending on Housing Benefit. Table 1.1 shows £9.2bn of Housing Association rental income came from Housing Benefit in 2014/15 whilst the sector as a whole made a surplus of £3.0bn. Housing associations protest that they are independent organisations. Whilst factually correct, this does little to dispel the Government's frustration.

Table B.1: Housing Benefit Expenditure & Housing Association Sector Surplus (2010/11 to 2014/15)[4 5]

	Government HB Expenditure, £ billion	Government HB Expenditure: Housing Associations, £ billion	Housing Association Sector Surplus, £ billion
2010/11	21.4	7.4	1.1
2011/12	22.8	8.0	1.8
2012/13	23.9	8.8	1.9
2013/14	24.2	8.9	2.4
2014/15	24.3	9.2	3.0

A lack of house building and new housing supply – both affordable and market – over the last 30 years has seen house prices and rents rise sharply relative to wages (and benefit income), meaning that more and more households are actually unable to access market housing – either to own or rent – and ever more

3 https;//www.gov.uk.government/statistics/statistical-data-return-2014-to-2015

4 Benefit Expenditure and Caseload Tables (2016) https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2016

5 Homes & Communities Agency, Global Accounts of Housing Providers (2011, 2012, 2013, 2014, 2015) https://www.gov.uk/government/collections/global-accounts-of-housing-providers

households, including those in work, are reliant on Housing Benefit to pay their rent. As a result, in the last 10 years the number of households claiming Housing Benefit has risen from just under 4m to just under 5m, many of which are in the private rented sector. During a time of fiscal restraint this ups the ante on Government to do something about housing supply more generally – and lean harder on housing associations to step up to the plate.

Finally, it is important to recognise that meeting housing need is not just about providing a sufficient number of homes. Over the years it has been just as much about decent homes. Indeed the challenge housing associations faced 40 or 50 years ago - and again more recently with the Decent Homes programme - was as much about providing decent housing as to address the housing shortage. New housing to replace that lost to the post-war slum clearance aside, the Rachman slums epitomised conditions in the private rented sector, which up until the late 1950s was the largest tenure in England.[6]

In sum, the debate around what housing associations are for is synonymous with the debate about what they should be spending their money on. Currently the Government believes they should be spending it on building homes, as do many (but certainly not all) housing associations.

B.2 Are housing associations public or private?

It still isn't clear whether the former Prime Minister made a slip of the tongue when, in Prime Ministers Questions, he provided the following response to a question from the leader of the opposition:

> *"I think it's vital though that we reform housing associations and make sure they are more efficient, frankly they are part of the public sector.."*[7]

It was immediately before the Office for National Statistics announced it was reclassifying housing associations as public sector organisations for the first time in their long history. But although the decision came as a surprise to some, the reality is that the status of housing associations over the last 20 years or so has been at best ambiguous, with some expert commentators settling for the term quasi-public or quasi-private. Historically, housing associations were most definitely private sector organisations, albeit ones not distributing a profit and most charitable. It was actually relatively recently, in the 1970s under the Heath Government, that the current blurring of housing associations as private sector organisations into quasi-public ones really began. And, unsurprisingly, it was about money.

To encourage housing associations to build new social homes, the Housing Act (1974)[8] introduced a new Government funding mechanism for housing associations – the Housing Association Grant (i.e. capital - or so called 'bricks and mortar' - subsidy). This was combined with loans from the Housing Corporation (now the Homes and Communities Agency, the social housing regulator). In many respects this was successful. The provision of generous grants led to the significant development of housing association social homes. Housing associations started to build a significant amount of social housing from the mid to late 1970s. All this was at a time when council house building was being diminished as a result of heavy public spending cuts needed to meet the conditions of Britain's International Monetary Fund bailout in 1976.[9] [10]

6 DCLG Live table 102 https://www.gov.uk/government/statistical-data-sets/live-tables-on-dwelling-stock-including-vacants

7 Prime Ministers Questions, 16th September 2015

8 http://www.legislation.gov.uk/ukpga/1974/44/contents

9 http://www.nationalarchives.gov.uk/cabinetpapers/themes/imf-crisis.htm

10 Moving Homes: The Housing Corporation 1964-2008, Alan Murie

And so housing associations now played a key role alongside councils in providing 'social housing' or specifically, homes for social rent – a submarket rent that today is typically 40% to 60% of market rent in a given local area. The provision of housing for social rent gave rise to the description of housing associations (as well as councils) as 'social landlords'.

But in many respects the Housing Association Grant has proved something of a poisoned chalice for housing associations. The Grant came with strings attached - it marked the beginning of regulation and the control of housing associations by the Government. To access the grant money, housing associations had to register with the Housing Corporation and meet its rules, including today's regulatory framework. Pretty much all of them did and hence housing associations generally became '*registered* social housing providers'. In many respects this arrangement was a happy one while grants remained at a higher level. But as new social housing association grants receded and became less generous, there was no commensurate reduction in the rules and regulations that went with them. And so it is that many housing associations complain about excessive regulation (as well as legislation around welfare and rents) preventing them from raising their own money to plug the gap left by the diminished housing association grant, to build the homes required to meet housing need.

In 1982, a new benefit – Housing Benefit – was introduced which essentially replaced an outdated system of rent rebates for council tenants and allowances for private tenants on low incomes. And so housing associations became even more financially dependent on central Government. Fast forward to the present day and two thirds of the housing association sector's rent – around 90% of its income - is paid by the Government through Housing Benefit (HB), although the biggest growth in HB spending has been in the private rented sector. Whether rightly or wrongly, and however much housing associations proclaim they are independent private sector organisations, Governments have increasingly felt they have legitimacy in directing and telling housing associations what do to. Unfortunately for the current Government, the Office for National Statistics decided at the end of last year that Governments have been telling housing associations what to do a bit too much, and reclassified them as public sector organisations. And so, at the stroke of a pen, £60bn of housing association debt (rising to £64bn today) was brought onto the public book.[11]

B.3 What Government and Housing Associations want

Despite some of the difficult tensions between the Government and sector in the last year, it is vitally important to recognise the commonality of interest. They share some of the main objectives: to reshape the sector as a whole to make it more efficient and further re-orientate it to house building to address the nation's housing shortage, and to extend the right to buy and shared ownership to housing association tenants to support aspiration (as well as bring in much-needed right to buy sale revenue receipts). The National Housing Federation's Ambition to Deliver stated that the sector could build 120,000 homes a year.[12]

The Government also wants housing associations to build homes, but without being overly dependent on Government money (i.e. housing association grant). The Government also wants to contain Housing Benefit Expenditure. Housing associations by and large do not want to be dependent on Government money

11 http://www.publicfinance.co.uk/news/2015/10/housing-associations-classified-public-bodies

12 http://www.housing.org.uk/resource-library/browse/an-ambi/

– moreover they want to be independent and autonomous of Government. However, the provision of affordable housing requires a subsidy from somewhere (Government or housing associations) and how much housing associations can provide depends in part on regulation and rent policy. Housing associations need certain regulatory freedoms and flexibilities to plug the hole left by diminished grant money, including the welcome deregulatory measures in the Housing and Planning Act (2016), which amongst other things will mean housing associations will now be able to dispose of (sell) their housing assets without the consent of the Regulator. Housing associations recognise too that the Government cannot give them carte blanche on rent setting because of the Housing Benefit implications, but equally they patently cannot borrow to build as much in an environment of social rent reductions.

To some extent, both sides are grappling with the same problems. These vital areas of common interest mean there is scope for a new approach to achieve the overarching objectives and deliver better housing outcomes, without the Government and housing associations being at loggerheads in a way conveyed by the now infamous Channel 4 Dispatches investigation into housing associations' record on housebuilding in Summer 2015.[13] The New Settlement is precisely about articulating that new approach.

13 http://www.channel4.com/news/housing-associations-homes-property-bob-blackman-david-orr

Chapter 1: Housing associations and housing building

1.1 Why housing associations should build

Today the biggest political challenge facing housing associations is for significantly increased home building. The acute shortage of housing means there is a need for most housing associations to maximise their housing provision for those in housing need. There are clear national interest arguments. Naturally, these are reflected in the political rhetoric, but they are fundamentally economic and social arguments:

> *"This country is not building enough homes. That is an economic as well as a social challenge."*[14]

There are many reasons why housing associations should be building more homes. The first reason is simply that the Government wants them to and given past and current public funding, as discussed previously, it has some legitimacy in asking. Housing associations' housing assets are today worth hundreds of billions of pounds - anywhere between £128.5bn and ~£300bn depending on the valuation method.[15] Much of this asset base has been built on the back of Government money, namely £45bn of social housing grant received since the 1970s with rents underwritten by Housing Benefit.

The second reason why housing associations should be building more homes is that the provision of housing is the central mandate of housing associations. So providing housing for as many in genuine need as possible is the cornerstone of any housing association's purpose. In an environment of a housing shortage, this must be about *increasing* the housing stock available through acquisitions and new build. New build is much preferred to acquisition because acquisition does not increase overall housing supply. There is already a national housing shortage with well over 1.2 million households on local authority waiting lists and a growing number of 'concealed households' that don't even figure on these waiting lists.[16] For example , there are 700,000 more 25-34 year olds living at home with mum and dad since 1997, despite no rise in the population of this group, with social consequences, such as having children later in life. Most of this group will not fall into a priority need category.

A third reason is more economic. The commercial volume developers can build 140,000 homes a year, on average, over the economic cycle (indeed fewer have been built by commercial developers in recent decades). While there is evidence they are slowly gearing up, moving north of that fundamental 140,000 will take many years and a benign economic backdrop. This is time we do not have. This is partly as a result of planning system constraints and partly because of a business model including a preponderance for building homes for market sale (rather than for market rent). New build homes for market sale have a low absorption rate in often highly localised markets - build too many homes in one locality at once and sale prices fall, hitting financial viability (and profit). Yet, it is widely accepted that

14 George Osborne, House of Lords Economics Affairs Select Committee, July 2015

15 Homes & Communities Agency, Global Accounts of Housing Providers (2015)

16 DCLG Live table 600 https://www.gov.uk/government/statistical-data-sets/live-tables-on-rents-lettings-and-tenancies

we need to build 240,000 homes a year to cope with our growing population. So we have a 'delivery gap' of 100,000 homes a year.

It is worth noting that in the council-house building heydays, councils plugged the 100,000 delivery gap by building council houses. Since the late 1970s councils have been unable to build on this scale largely because of constraints on their spending and borrowing (local authority borrowing caps). It is no coincidence that, in the absence of radical liberalisation of the planning system, we have had a housing shortage ever since. It is unlikely that councils will ever be able to ramp up to these levels again - they certainly won't be able to without significant policy changes and easing the local authority borrowing caps would be inconsistent with the Government's fiscal stance. Central Government is not going to plug the delivery gap either. Whilst the new 'direct commissioning' policy signals a shift in the Government's stance, the scale of direct delivery is likely to be modest. The future devolution deals might see a further shift towards the direct commissioning approach by the devolved administrations, but there is no guarantee of this.

1.2 Housing associations' record on housebuilding

The former Chancellor was critical of the housing association sector's house building record when he appeared before the House of Lords Economic Affairs Select Committee in Summer 2015:

"The number of homes that large housing associations are building is not particularly impressive in my view."

So how many homes are housing associations actually building? Part of the problem is that no one knows the definitive answer to that question. Although we know how many affordable homes housing associations are building, there is no compilation of the data for the market homes they build and hence the total. The aspiration of this report is for housing associations in England to build 100,000 affordable and market homes a year to plug the 'housing gap'. According to the official data, housing associations and councils built on average 48,000 affordable homes a year during the last 5 years (2010-11 to 2014-15). Around 46,000 of these were built by housing associations, ~2,000 by local authorities.

Table 1.1: Total affordable homes built in England, 2005/06 to 2014/15* [17]

	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15
Social rent	20,510	21,440	25,660	27,600	30,400	35,180	34,920	16,870	10,220	8,470
Affordable rent	..	..	..	..	..	..	770	6,050	15,840	35,400
Intermediate. rent	1,370	1,110	1,050	1,690	1,910	2,390	1,700	820	690	180
Shared. ownership	11,380	13,680	17,460	14,940	15,750	15,570	15,460	15,760	9,890	14,500
Total affordable	33,260	36,220	44,180	44,220	48,060	53,140	52,840	39,510	36,640	58,560
Average	~41,000 p.a.	~48,000 p.a.								

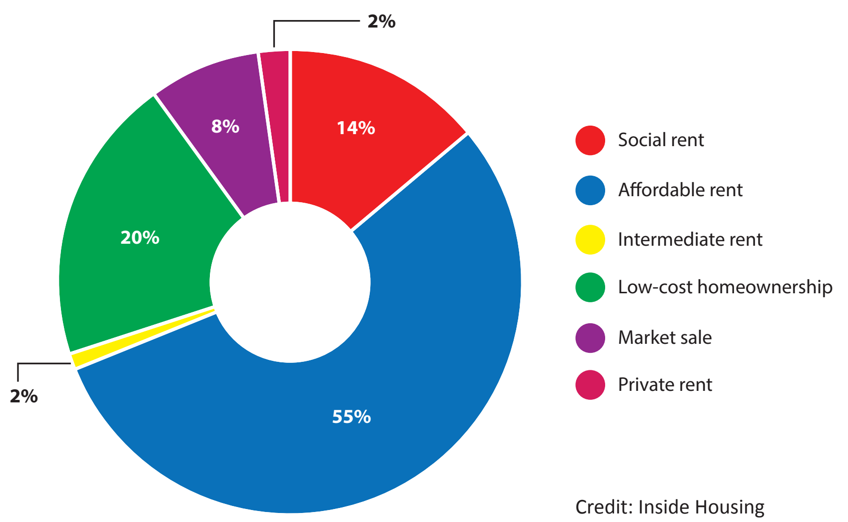
17 DCLG Live table 1009 https://www.gov.uk/government/statistical-data-sets/live-tables-on-affordable-housing-supply

Affordable house building figures are choppy from one year to the next, driven largely by Government grant funding cycles. That's why it is important to take multi-year averages. Indeed, housing associations and councils built 58,500 affordable homes in 2014-15 (56,000 HA). On the positive side, the average number of homes built over the latest 5 years (48,000) is higher than the previous 5 years (41,000), and housing associations have committed contractually to building around 50,000 affordable homes a year over the current Affordable Homes Programme (2015-18). On the negative side, that number is way short of what housing associations could and need to be building.

One of the better efforts to compile data on the total house building by housing associations is Inside Housing's annual poll of housing associations.[18] As a caveat, some have questioned the accuracy of the poll – some housing associations have complained the figures for their organisation are inaccurate. Inside Housing also only publishes figures for the Top 50, though these do account for 60% of the sector's social housing stock / aggregate surplus.

What the polling can usefully do is give a decent sense of how many *market* homes housing associations are building: the results suggest that around 10% of the homes built by the top 50 are for the market – most for sale (8%) but some for rent (2%). This can be applied as a mark-up to the affordable homes associations are building to give an indicative total.

Tenure of Completed homes 2014/15



Credit: Inside Housing

In sum, in addition to the 56,000 affordable homes the housing association sector built in 2014/15, a decent estimate is that it built an additional ~6,000 market homes, so around 62,000 in total (62% of the 100,000 aspiration). Going forwards, the average number of homes the housing association sector builds should rise moderately, to 55,000 on average over the coming period to 2020 under current policy: 50,000 affordable homes associations are committed to building, plus ~5,000 market ones.

As context, the sector's affordable housing stock is 2,647,000 homes[19], so building 100,000 homes a year would represent 3.75% of their affordable housing

18 http://www.insidehousing.co.uk/analysis-and-data/data/the-tipping-point/7010136.article?adfesuccess=1

19 Homes & Communities Agency, Global Accounts of Housing Providers (2015)

stock, a de facto house 'build rate' of 3.75%. However, the sector average house building rate is only 1.8% currently. And looking at the sector aggregate clearly does not tell the whole story – some housing associations are building much more than others (some aren't building at all). Similar to Inside Housing's polling work, we ranked housing associations by their affordable home building rate in 2014/15 to arrive at a 'Policy Exchange Top 60'. However, instead of polling data for the number of homes built we used actual Global Accounts data (table 1.2). The table shows it is possible for housing associations to achieve build rates of 3% to 4%, though we add the caveat that this is only one year of data.

Table 1.2: Policy Exchange Top 60 affordable home building housing associations (ranked)[20]

	Housing Association	Affordable homes managed	Affordable homes built	Build rate
1	Islington & Shoreditch Housing Association Ltd	1975	151	7.6%
2	Hightown Housing Association Limited	4121	315	7.6%
3	Rooftop Housing Group Limited	5918	327	5.5%
4	Saffron Housing Trust Limited	5483	288	5.3%
5	Waterloo Housing Group Limited	19068	986	5.2%
6	The Wrekin Housing Group	11459	586	5.1%
7	Soha Housing Limited	5946	303	5.1%
8	Wulvern Housing Ltd	5442	272	5.0%
9	Equity Housing Group Limited	3306	159	4.8%
10	Colne Housing Society Limited	2976	141	4.7%
11	Sentinel Housing Association Ltd	8977	422	4.7%
12	Fortis Living	14411	654	4.5%
13	Wandle Housing Association Limited	7023	316	4.5%
14	Great Places Housing Association	16849	745	4.4%
15	Unity Housing Association Limited	1192	52	4.4%
16	Howard Cottage Housing Association	1600	69	4.3%
17	Knightstone Housing Group Limited	11198	473	4.2%
18	Town and Country Housing Group	8952	377	4.2%
19	Hastoe Housing Association Limited	4881	203	4.2%
20	Inquilab Housing Association Limited	1214	48	4.0%
21	Housing Solutions Limited	5129	197	3.8%
22	bpha Limited	14749	551	3.7%
23	Manningham Housing Association Limited	1419	53	3.7%
24	Sovereign Housing Association Limited	34998	1258	3.6%
25	Derwent Housing Association Limited	8431	303	3.6%
26	Paragon Community Housing Group Limited	7676	266	3.5%
27	Estuary Housing Association Limited	3814	132	3.5%
28	Catalyst Housing Limited	18404	636	3.5%
29	Housing & Care 21	18508	638	3.4%
30	Orbit Group Limited	38465	1312	3.4%
31	Paradigm Housing Group Limited	12835	434	3.4%
32	North Devon Homes Limited	3200	106	3.3%
33	Broadacres Housing Association Limited	5724	186	3.2%
34	Network Housing Group Limited	18022	579	3.2%
35	Adactus Housing Group Limited	13216	422	3.2%
36	Notting Hill Housing Trust	27929	878	3.1%

20 Homes & Communities Agency, Global Accounts of Housing Providers (2015) [Spreadsheet Data]

37	West Kent Housing Association	6767	212	3.1%
38	Westward Housing Group Limited	7019	213	3.0%
39	Moat Homes Limited	20896	618	3.0%
40	Cross Keys Homes Limited	10318	305	3.0%
41	Suffolk Housing Society Limited	2657	78	2.9%
42	Gateway Housing Association	2762	80	2.9%
43	Hundred Houses Society Limited	1192	34	2.9%
44	Arcon Housing Association Limited	1197	34	2.8%
45	Nottingham Community Housing Association 2014	8434	238	2.8%
46	Acis Group Limited	5553	155	2.8%
47	Hexagon Housing Association Limited	3668	102	2.8%
48	Longhurst Group Limited	18552	512	2.8%
49	Devon and Cornwall Housing Limited	20877	563	2.7%
50	Tuntum Housing Association Limited	1302	35	2.7%
51	Spectrum Housing Group Limited	13941	371	2.7%
52	Genesis Housing Association Limited	30518	801	2.6%
53	Hyde Housing Association Limited	49646	1292	2.6%
54	Coastline Housing Limited	3934	102	2.6%
55	Accord Housing Association Limited	12725	329	2.6%
56	North Star Housing Group Limited	2082	53	2.5%
57	First Wessex	17595	446	2.5%
58	Midland Heart Limited	30437	766	2.5%
59	Saxon Weald Homes Limited	5753	143	2.5%
60	Two Castles Housing Association Limited	3598	89	2.5%

- **Recommendation 1**: Housing associations signing up to a Housing Deal should commit to a 3% to 4% build rate for the duration of the Deal, with the precise rate unique to their deal determined through negotiation.

1.3 Building homes in the right places

One key issue with the national interest argument for house building – as discussed in Chapter 2 - is that it creates a natural tension with what is often a locally oriented modus operandi of housing associations. This is partly historical with housing associations often founded by citizens in a locality. It is also about local government boundaries – local authority waiting lists, locally defined housing need, planning permissions and local (authority) nomination rights that give councils the right to choose which tenants go into vacated housing association homes.

Clearly one problem with 'local' is that although we have a national housing crisis, it is not a ubiquitous housing crisis. One measure of housing need by local authority is the local authority waiting lists. However, these are an imperfect measure of housing need (or indeed demand) as waiting list restrictions differ from one local authority to the next. But it is one of the best measures we have of need and indicates wide variation in housing need in different parts of the country:

Table 1.3: Local Authorities with the longest housing waiting lists, 2014/15[21]

Local Authority	Household population (no. Households)	Housing waiting list (no. Households)	Waiting list a % of household population
Camden	99,828	24,644	24.7%
Islington	96,872	19,196	19.8%
Barking & Dagenham	71,079	13,579	19.1%
Tower Hamlets	105,379	19,783	18.8%
Brighton and Hove U	124,417	22,182	17.8%

The national interest argument implies that housing association resources will need to move more freely across local authority boundaries and flow to the local authorities (and localities) where new homes are needed the most. It is important to recognise the different types of housing need: new supply in high demand areas on the one hand and replacement in regeneration areas on the other. This is should also be seen in the context of the devolution deals (and the Northern Powerhouse). Moreover, devolution means this is no longer a local or national dynamic, strategic thinking is happening at the city region and sub-regional levels (e.g. Enterprise Partnerships). This is where strategy and resources will increasingly be focused.

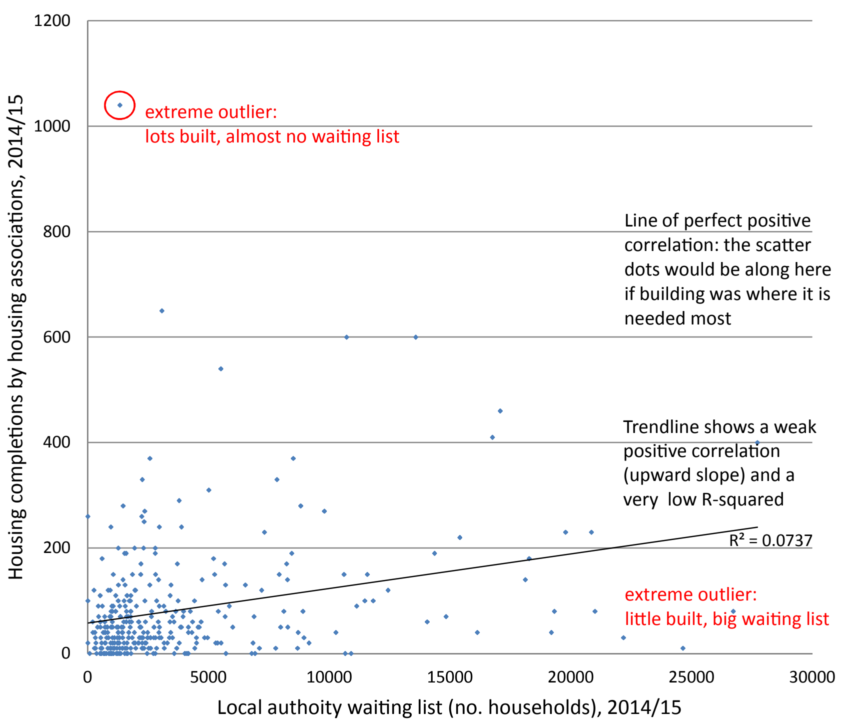
Upon establishing the principle that we need to build homes where they are needed the most, underpinned by the national interest argument, it would not be enough for any housing association Chief Executive to say "There isn't any demand for new housing in my area, where I operate. So I don't need to build any homes." Through the New Settlement construct, the Government should encourage housing associations operating in local areas of low housing need to invest in building housing in different areas of high housing need. Such a housing association could actually do so in many ways but most obviously with a partnering housing association. Another way is through merger (see chapter 3). Indeed, the greater ability of a larger housing association to flex, move and allocate house building resources across a larger geographical spatial area to where homes are needed the most within it is one important argument for this.

Are housing associations already building homes where they are needed the most? One way to answer this is to map each local authority's housing waiting list housing against the number of homes housing associations are actually building there. If housing associations were building homes where they are needed the most, they would be building more in the local authorities with the longest waiting lists – i.e. a strong positive correlation between the two. The data for 2014/15 are not encouraging in this respect: there is only a very weak positive correlation as shown in the next chart - the trend line whilst upward sloping, is only slightly so (the dashed line above is where it should be), and the 'R squared' is very low.

One of the interesting features of the chart is the lack of local authorities in the top right hand quadrant of the plot area. Plots here would be indicative of lots of building by housing associations in local authorities with very high waiting lists. This helps explain the very weak correlation between house building and waiting list lengths. Unfortunately, the same may well be true of house building by the commercial developers.

21 DCLG Live table 600 https://www.gov.uk/government/statistical-data-sets/live-tables-on-rents-lettings-and-tenancies

Chart 1.1: A cross-plot of housing association housebuilding and waiting list, by local authority



It is also worth noting that such weak correlation could be symptomatic not of a lack of money (or desire) on the part of housing associations to build in the local authorities where homes are needed most, but difficult local politics and planning preventing this happening.

1.4 Could the housing association sector build more?

The importance of linking capacity to build with housing association surpluses is reflected in the current political narrative:

> *"I don't mind housing associations making large surpluses, so long as they use them to build homes."*[22]

A housing association's surplus is its income - mainly rents and service charges - less costs such as operating costs of management, routine maintenance, major repairs and debt interest. Surpluses are a bit like profits in the commercial world (except they are not distributed to shareholders). In 2014/2015, the housing association sector made an aggregate surplus of £3bn (£2.3bn in 2013/14). In essence, the current Government wants housing associations to use their surpluses and borrowing capacity to build homes. The Government also wants them to be more efficient: higher surpluses mean more borrowing capacity and hence more house building potential.

To draw another analogy, when mortgage lenders conduct an affordability assessment of individuals seeking to take out a mortgage with them, they use an

22 Brandon Lewis, former Minister of State for Housing and Planning.

individual's, or couple's, disposable income (income less essential expenditure) as a measure of how much they can borrow. Similarly, in a commercial lender's eyes, a housing association's surplus is one measure of how much it can afford to borrow. However, a housing association's surplus can look misleadingly high in a very low interest rate environment, as we have now, especially if its debt levels are also high - the surplus would fast dissipate if interest rates were to rise. So there is the question about whether surplus alone is the right metric for a housing association's financial capacity to borrow and build. It probably shouldn't be the only one.

Could housing associations borrow much more on a sustainable basis to build more homes? Much of the housing association sector's development finance to build new homes is through secured borrowing (in essence, mortgages on the individual homes they own). The value of the sector's housing stock, including depreciation, currently stands at £128.5bn[23], or £48,500 per home. This valuation seems very low and indeed the valuation methods used for the sector by commercial lenders are a subject of much debate, not least because at open market sale (as obtained for example by selling them through the Right to Buy, excluding the right to buy discount) the value of the sector's housing stock would be closer to £300bn and comfortably over £100,000 per home. Crucially, though, the £128.5bn figure is the important one because it is the basis on which many commercial lenders will lend to housing associations for secured borrowing purposes.

The sector currently has £63.5bn of debt (£24,000 per home) - including £50.9bn of long term loans[24], essentially mortgage debt secured against individual properties – as well as other shorter term and non-secured borrowing by housing associations. In slightly simplistic mortgage loan to value terms, this translates to a fairly modest loan to value (LTV) of 49%, namely £24,000 loan to £48,500 value. This percentage is not especially high and actually quite similar to lenders' loan book for all their other residential mortgages. It is worth noting that mortgage lenders usually offer the best mortgage interest rates to individual households at up to 60% or 65% LTV.

It is also important to note that the common measure of indebtedness in the sector is the rather archaic 'gearing ratio' - also reported in the Regulator's Global Accounts – which is very different to an LTV gearing measure. Gearing ratios are often used in lending covenants between lenders and housing associations – one of the sponsors of this report has lending covenants which defines the maximum they can borrow in terms of a 'gearing ratio' of 75%. Other housing associations have a lower maximum which may need to be challenged.

Clearly it is intuitive that a housing association with a healthy surplus AND with borrowing capacity has the financial muscle to invest in building more new homes. But it is interesting, referring back to the Policy Exchange Top 60 housing associations ranked by building rates, that (1) they have average debt-gearing positions not too dissimilar to the sector average ; and (2) their average surplus per home is actually fairly similar to the sector average.

How can we assess borrowing capacity across the sector? One way is to consider whether borrowing across the sector be at 60% LTV instead of 49% LTV. Many housing associations do have an LTV above 60%. In a 60% LTV world, the sector's debt would be £77.1bn instead of £63.5bn. The following table considers the cost implications of this at the sector level:

23 Valued at a mixture of existing use value of social housing or "EUV-SH", typically 30%-40% of open market sale value (in essence based on future social rent income streams), and market value subject to tenancy "MV-ST", typically 60% of open market sale value.

24 Recorded as long term loans in the HCA's Global Accounts of Registered Providers

Table 1.4: Sector income and expenditure with higher debt levels and higher interest rates

	Current (2014/15)	Envisaged @ current 4.0% interest rates	Envisaged @ higher 6.5% interest rates
Loan to value	49%	60%	
Debt	£63.5bn	£77.1bn	
Operating surplus	£4.6bn	£4.6bn	
Interest cost (net)	-£2.6bn (~4%)	-3.1bn (~4%)	-5.0bn (~6.5%)
Asset sales & other	£1.0bn	£1.0bn	
Surplus	£3.0bn	£2.5bn	£0.6bn

Notwithstanding the transition from current to envisaged LTV rates rather than world would take at least 5 years (it would not be instantaneous), housing association sector debt at an equivalent 60% LTV does appear affordable in the sense that a positive surplus is sustained – though much diminished. This is true even when stress tested against much higher interest rates (at 6.5% versus a sector average of 4% currently – indeed some bond issues are as low as 2%). Further, no account is taken of the additional sales or rental income from the new homes built in this illustration.

- **Recommendation 2**: Housing associations, in discussion with their commercial lenders, should consider raising their debt levels to support house building – or ' borrow to build'. Borrowing at 60% LTV, on the basis of current valuation methods, should be posited as a sector-wide prudential benchmark.

- **Recommendation 3**: Government should support this new sector-wide prudential benchmark by exempting housing associations that 'borrow to build' from the social rent reductions, instead allowing them social rent increases of between zero and CPI – typically 2% a year. It should also consider the extension of Affordable Housing Guarantees to support higher borrowing levels at attractive interest rates.

'Borrow to build' underpinned by strong surpluses should be an integral part of the New Settlement.

The additional £13.6bn of borrowing moving to 60% LTV could pay for the one-off construction of 90,000 new homes at a cost of £150,000 per home, say 18,000 a year over five years. One option then could be to build all the 90,000 homes for the market. But housing associations face the same risks as commercial developers selling these extra homes and the same low local market absorption constraints: whilst they can build the 90,000 they might not be able to sell them. To help manage this risk and underpin demand for these new homes, housing associations should offer them as an additional purchase option to their social tenants wanting to exercise their Right to Buy. So their social tenants would be able to choose whether (i) to buy the home they live in at the Right to Buy discount or (ii) buy a new build one at the same discount (i.e. a 'portable' Right to Buy) in the open market. Of course, some of the new homes could also be let at market rent, but the scope is limited.

- **Recommendation 4**: Housing associations should offer their existing social tenants eligible for the Right to Buy the portable Right to Buy to support expanded house building for open market sale programmes.

Table 1.5 shows how the £13.6bn could be used and recycled to build homes for the market on an ongoing basis if the market sale risks were fully mitigated:

Table 1.5: Sector-wide 'Borrow to Build' homes built and development finance

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6+
Market homes planned, started	18,000	18,000	18,000	18,000	18,000	18,000
Market homes completed	-	-	18,000	18,000	18,000	18,000
Market homes sold:	-	-	16,000	16,000	16,000	16,000
o/w portable RTB sale	-	-	8,000	8,000	8,000	8,000
o/w open market sale	-	-	8,000	8,000	8,000	8,000
Market homes let	-	-	2,000	2,000	2,000	2,000
Development finance required (a)	-£2.7bn	-£2.7bn	-£2.7bn	-£2.7bn	-£2.7bn	-£2.7bn
Additional borrowing of £13.6bn over 5 years (b)	£2.7bn	£2.7bn	£2.7bn	£2.7bn	£2.7bn	NIL
Additional interest cost (c)	-£0.1m	-£0.2m	-£0.3bn	-£0.4bn	-£0.5bn	-£0.5bn
Sales receipts at cost (d)	-	-	+£2.4bn	+£2.4bn	+£2.4bn	+£2.4bn
Net rental receipts @3.5% yield (e)	-	-	+£10m	+£20m	+£30m	+£40m
Free cash reserve in yr change (a+b+c+d+e)	-£0.1m	-£0.2m	+£2.1bn	+£2.0bn	+£1.9bn	-£0.8bn
Free cash reserve cumulative	-£0.1m	-£0.3m	£1.8bn	£3.8bn	£5.8bn	£5.0bn

Some detractors might liken this model to a perpetual motion machine. But the principle is simple: a one off increase in the sector's borrowing, from an equivalent 49% LTV to 60% LTV over 5 years, to raise the funds to build market housing that can be recycled on an ongoing basis in a stable or rising housing market, with the housing market risk appropriately managed. This model would mean housing associations building an additional 18,000 market homes a year which, combined with the 55,000 homes a year they are likely to build in the coming years could get the sector building 73,000 homes a year (50,000 affordable and 23,000 market). It gets us closer to the magic 100,000 homes a year figure over the 5 year period and, to the degree cash is generated from the new build sales, a significant period beyond.

1.5 What tenure housing associations should build

Housing associations should build a mixed economy of housing. Clearly the new homes housing associations build in the future will no longer be as predominantly for affordable and/or social rent as they have been in the past. Housing associations will need to operate in a world of much less Government grant money for social or affordable rent housing. The Spending Review (2015) did commit £4bn of grant money, but for 135,000 new shared ownership homes (see box below), so the Government remains committed to funding affordable housing from the public purse but not for rent (see box). As a result, housing associations will inevitably build more homes for ownership within their affordable offer.

Box 1.1: Spending Review 2015 – Housing commitments

- £2.3bn for 200,000 Starter Homes
- £4.0bn for 135,000 Help to Buy: Shared Ownership homes
- £0.2bn for 10,000 reduced Rent to Buy homes
- £0.4bn for 8,000 specialist homes for older and disabled people

But more than that, housing associations will need to build many more homes for the wider market – both homes for open market sale and homes for market rent.

There are three overarching reasons why housing associations should build a mixture or market and affordable homes and across the tenures – the so called 'mixed economy' of new housing - and not just social housing. These are: (1) to underpin housing mix for better social integration and cohesion of households in new housing; and (2) to enable housing associations to be more self-financing and less dependent on Government money and, hence, more independent of Government and (3) the country needs more market homes for sale including for those with relatively low incomes to enter homeownership. This also creates flexibility and liquidity in the market.

Of the first, a mixed economy of housing actually supports the desired mixed housing development approach that has been embraced fairly broadly across the political spectrum. To be clear, simply maximising the number of affordable homes on a given site is not a desirable policy outcome, other than perhaps for very small sites. Just as Estates – mono-tenure social rented housing (100% affordable housing) - proved to be highly undesirable and correlated with poor social and economic outcomes, a new development with a tenure mix that is 50% affordable housing and 50% market housing probably is not preferable to one that is 20% affordable and 80% market for place in the long run, for similar reasons. This is most likely to be true of very large developments and of course depends on the tenure mix of the wider area. The point is more affordable housing at the expense of market housing isn't always better in the longer run for the communities concerned.

To put a 50% affordable housing requirement into perspective, England's current housing stock, by tenure, is just over 63% homeownership, 19% market rented and 18% affordable (or social) rented[25]. That means that a mere 1 in 6 homes in the existing stock are affordable - mostly social rented, some affordable rented and some shared ownership. This is clearly out of kilter with the oft-cited 30% affordable housing requirement of many local authorities in England and the 50% affordable housing requirement of many London boroughs, motivated not just by local politics but also by the acute housing shortage in these areas.

25 DCLG English Housing Survey, 2015

As a thought experiment, if the nation's house building output was along the lines of the existing stock in terms of tenure split, and if we were building the 240,000 homes a year we need, then the house building splits would look something like:

Table 1.5: Building 240,000 homes a year – by builder type and affordable / market home mix

Housebuilder type	Total homes built p.a.	Affordable or market	Share of total homes built
Housing associations	100,000	50,000 affordable	~1 in 6
		50,000 market	~1 in 6
Commercial developers	140,000	140,000 market	~4 in 6 (2 in 3)

This, it is argued in this report, is what "good" looks like in terms of house building in England and what the New Settlement should try to achieve. It says that housing associations should not need to build more than 50,000 affordable homes a year broadly what they are building currently, other than through the Right to Buy sale replacement policy. What we actually need is for housing associations to build much more market housing (they are only building ~5,000 homes a year currently).

The challenge is how they can build into the same market as commercial developers without crowding them out (i.e. building market homes in addition to the ones commercial developers build, not instead off). One way is to use the portable Right to Buy idea (see recommendation 4). Another is for housing associations to build many more homes for the institutional market rented sector. Here they cold exploit synergies where they can exploit synergies with their affordable housing landlord function and be part of a concerted push to increase the institutional private rented sector.

Fundamentally, the ability of housing associations to scale up their build for market sale or build for market rent depends on their attitude to risk. Some of the largest housing associations operating in the most vibrant housing markets may take one view. But 50% market housing will for many housing associations be a massive challenge unless they can be encouraged to operate in more buoyant markets, notwithstanding markets move up and down.

The second reason housing associations should build a mixed economy of new homes, is the need for housing associations to be self-financing and more self determining - a key plank of the 'independent housing associations' narrative. Self financing, in essence, is about housing associations using cross subsidy (i.e. subsidy from their own resources, not from the Government) to finance affordable house building. Increasingly, the larger housing associations – especially those operating in the London markets - are building homes for market sale and using the profits from this to cross-subsidise the building of affordable homes. A 50:50 split of affordable : market, for example, implies that the profits from building and selling each market home cross-subsidizes the provision of each affordable one. However, a reliance on a buoyant housing market to cross-subsidise affordable house building inherently makes housing associations more pro-cyclical, whereas the government grant model, if anything, always made them counter-cyclical. During the Great Recession housing associations accounted for half the nation's house building as commercial housebuilding nosedived.

There are other challenges. Housing associations operating in areas where housing market conditions are weaker and land values lower will not be able to generate sufficient profit from market housing sales to cross subsidise affordable housing to any significant degree: housing associations need to build market housing where demand is highest in this respect.

1.6 How to finance building 100,000 new homes a year

Building 100,000 homes a year would require land and capital investment in the order of at least £15bn a year (£150,000 per home). This section considers how this could be financed at the sector aggregate level through a myriad of measures including 'borrow to build' (recommendations 1 and 2, discussed earlier). To illustrate how, the following assumptions are made:

- sector borrowing rises from an equivalent 49% LTV to 60% LTV over 5 years under "borrow to build", to finance building 18,000 homes a year
- the sector's *affordable housing* stock grows by 50,000 homes a year (+1.8%) over the next five years, growth which can be borrowed against sustainably
- the value of the sector's affordable housing stock rises by 2% nominally each year, allowing 2% additional borrowing each year sustainably against each existing home. This implicitly assumes social rents increase 2% a year, broadly in line with CPI, i.e. outside of rent restrictions.
- the Right to Buy extension policy and additional measures (to be discussed) generate an additional 15,000 RTB sales a year, with full compensation for the RTB discount from the Government. This provides a total receipt of £100,000 per home / £1.5bn a year sector-wide
- Government grant funding for shared ownership homes of £1.3bn a year ongoing in line with Spending Review 2015
- Aggregate sector surpluses of £3bn a year are sustained and grow in line with the housing stock, with the effect of future interest rate rises fully mitigated by an appropriate term structure of debt finance and future cost saving efficiencies
- Alternative Investment (i.e. non-debt finance) in the order of £1bn a year, which would mainly be equity financing, for example from public or private pension funds

Table 1.5 puts this all together. It shows how the available development finance across the housing association sector could be increased by 50% from just over £10bn p.a. currently to the £15bn p.a. needed to build 100,000 homes a year (bottom row). However, there are a number of uncertainties, including the extent to which starter homes will reduce Section 106 funding for housing associations to build affordable homes and how far housing associations can innovate to attract equity investment (pension fund money). The table serves to illustrate the scale of the funding challenge.

Table 1.5: How £15bn p.a. of development finance could be raised

Sector Aggregates	Current		Proposed					
Affordable Housing Stock	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2030/21	Averages
No. Homes (millions)	2.65	2.7	2.75	2.8	2.85	2.9	2.95	N/A
Value (£bn)	128.5	133.4	138.5	143.9	149.4	155.1	161.1	N/A
Borrowing								
Loans (£bn)	63.5	67.6	72.2	78.1	84.1	90.2	96.6	NA
Loans to value(%)	49.4%	50.7%	52.1%	54.3%	56.3%	58.2%	60%	NA
Income for development spend (£bn)								
Annual surplus	3.0	3.1	3.1	3.2	3.2	3.3	3.3	3.2
New borrowing	4.1	4.1	1.9	3.2	3.3	3.4	3.6	3.1
Borrow to build	0	0	2.7	2.7	2.7	2.7	2.7	2.7
Social Housing Grant	1.1	1.1	1.1	1.1	0.0	0.0	0.0	0.4
Grant for S/0	0.0	0.0	1.0	1.0	1.0	1.0	1.0	1.0
Section 106	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
VRTB sale receipts	0.0	0.0	1.5	1.5	1.6	1.6	1.6	1.6
Alternative equity investment	0.0	0.0	1.0	1.0	1.0	1.0	1.0	1.0
TOTAL	**10.2**	**10.3**	**14.3**	**15.7**	**14.8**	**15.0**	**15.2**	**15.0**

Chapter 2: Housing Associations And Shared Ownership

2.1 Why housing associations should encourage homeownership

Many households want to own their own home. Meeting that aspiration - as responding to what the electorate wants more generally - is a legitimate policy objective for any Government.

Around 86% of households aspire to own their own home, according to the British Social Attitudes Survey. This is broadly in line with other surveys showing often similarly high readings. The expectation to buy (a proxy for homeownership aspiration), is also significant amongst social renters. Nearly one in four (23.8%) of all social tenants say they expect to buy a home in the UK. This figure is similar for social tenants living in housing association homes (23.2%). Over half a million housing association social tenants, 513,000 of them, say they expect to buy a home at some point, though most of them (319,000) after 5 years.[26]

Households clearly place value on being able to own their own home, whether one calls it social value, or simply pride, or something else. Overwhelmingly, the benefits of owning your own home are private and revolve around the accumulation of an asset. Housing wealth is by far the biggest component of household wealth in the UK - much of the wealth inequality in our country is driven by those who own and those that don't – homeownership often defines the haves and the have nots.

As discussed in the previous chapter, within the next 5 years it is likely that housing associations will be building much more of a mix of homes: homes for submarket rent (both social and affordable rented homes as well as other submarket categories), the new Starter Homes for outright market ownership, and an increased slice of shared ownership homes (not to mention homes for market sale). This shift is already happening and is driven by the Government's push on homeownership, all underpinned by the 'One Nation' mantra.

This all bodes well for future housing association households and the opportunities they will have to enter homeownership. But the challenge is not just in the space of new…." - removing the phrase about diversity of the housing offer the challenge is not just in the space of new build homes: what about existing housing association households? Although there is still much to do to achieve the 'mixed economy' of house building by housing associations as a whole, arguably a bigger challenge is actually with the housing association stock, which remains overwhelmingly social rented housing (over 90% of households). The extension of the Right to Buy to housing association social tenants will make only limited inroads into this, as explored below. This does not bode well not only for social mix in the existing stock of housing association homes, but also for the half-a-million households living in them that aspire to own their home one day.

26 English Housing Survey 2014/15 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/501065/EHS_Headline_report_2014-15.pdf

2.2 The need to encouraging ownership amongst existing tenants

It is certainly true that there are some households that simply cannot (and should not) be able to buy their own home – for example, households that are wholly dependent on benefits or unable to work, as well as highly vulnerable households. Supporting households into homeownership should always be done on the basis that they are able to sustain it. So if Government wants to push the homeownership envelope much further down the income scale amongst traditional social renters (and beyond the Right to Buy extension policy), it will likely require additional financial support for these households probably on an ongoing basis from Government and/or housing associations.

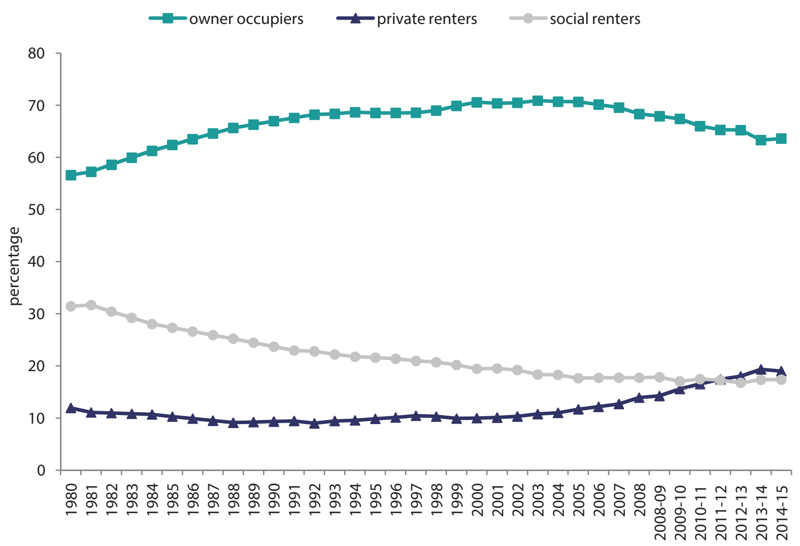
There are currently around 2.7m households living in housing association homes, of which around 2.3m are social renters. As with households living in a council homes, it was originally mooted that those who have been social tenants for three years or more will be eligible for the Right to Buy, but currently a 10 year eligibility period is being piloted to manage initial demand. It is estimated that around 1.4m housing association households have been social tenants for 3 years or more. The Right to Buy extension may eventually give these 1.4 million housing association tenants the right to buy their own home on a similar eligibility basis as council tenants and with the same price discounts once the likely initial demand spike has been managed. However 550,000 of the 1.4 million already have the (Preserved) Right to Buy as stock transfer social tenants, leaving potentially an additional 850,000 eligible as a result of the extension policy.

Estimates about how many of the 850,000 newly eligible housing association households will take up their RTB vary but they are actually fairly modest. The Sheffield Study, produced by Sheffield Hallam University for the DCLG House of Commons Select Committee, suggests only up to 170,000 households will do so.[27] The early National Housing Federation (NHF) work estimated up to 221,000 – would be eligible and able to afford their right to buy not all of whom will necessarily take it up.

The Government is concerned that homeownership has been in broad decline over the last 12 years or so (though it did tick up marginally last year). The homeownership tenure share has fallen from a peak of 70.9% in 2003 to 63.6% in 2014/15, according to the English Household Survey. The Sheffield Report concluded the Right to Buy extension could "temper" the recent decline in owner-occupation, but will not on its own be enough to reverse it. Indeed, there are currently 22.5 million households in England. So if the Sheffield and NHF estimates are accurate, fewer than 1% of households will switch from being social renters to homeowners. The overall tenure share effects will be partly mitigated further by the one for one replacement policy, through which homes sold under the Right to Buy are replaced one for one by new affordable homes, though not all necessarily for rent. Half a million or so housing association social tenants expect to buy a home at some point in their lives. A more significant take up of Right to Buy, probably in the order of that 500,000, would be needed to make a discernible impact on home ownership levels at the aggregate level. So given it is unlikely that significantly more than 170,000 to 221,000 housing association households will the take-up of the Right to Buy extension, the Government will need to go further.

27 https://www.parliament.uk/documents/commons-committees/communities-and-local-government/Full-Report-for-Select-Committee-141015final.pdf

Figure 2.1: Trends in tenure, 1980 to 2014-15



Base: all households
Note: underlying data are presented in Annex Table 1.1
Sources:
1980 to 1991: DOE Labour Force Survey Housing Trailer;
1992 to 2008: ONS Labour Force Survey;
2008-09 onwards: English Housing Survey, full household sample

So how could the 500,000 be achieved and what policies could be adopted to make it happen? Firstly, it could be achieved by extending the shared ownership offer to existing households through a new *right to shared ownership*. At its simplest, this would give all housing association social tenants the right to buy a *share* of their home, but at the current market price (without a discount). In practice this could be any ownership share they liked - but perhaps with a 25% share as the minimum, noting that many mortgage lenders will only lend a minimum of £30,000 on a new mortgage subject to the affordability requirements.

However, the Right to Buy, with its generous discounts of ~50% on average in 2014/15[28], will remain by far the most attractive offer for households able to afford it. Indeed, in thinking about the choices that existing household association social tenants face, why buy a 50% share of a £100,000 home for £50,000 and enter a shared ownership arrangement with your housing association, when you can buy the whole thing for £50,000 under the Right to Buy extension policy? Unsurprisingly, there is a widely perceived unfairness that those entering shared homeownership do not receive the price discount they would otherwise receive by exercising their right buy.

28 DCLG Live tables 678 and 682 https://www.gov.uk/government/statistical-data-sets/live-tables-on-social-housing-sales

Table 2.1: Registered Provider Social Housing Sales

Registered Provider Social Housing sales	Sales	Average Capital Recepts per dwelling (£)	Average Discount per dwelling (£)	Average Market Value per dwelling (£)	Discount as percentage of market value
2010-11	956	64,860	28,130	95,330	**30%**
2011-12	1,106	61,140	28,410	90,380	**31%**
2012-13	2,548	49,510	50,120	100,460	**50%**
2013-14	4,421	51,060	54,240	105,300	**52%**
2014-15	4,215	51,060	54,920	105,980	**52%**

This links to a further point that shared ownership households face all the costs of maintenance and repairs, even if they only own a 25% share of their home. They have all the costs of homeownership and only a fraction of the benefits. This too needs to be addressed so that housing associations and households pay their fair share of the costs of maintaining and repairing a shared ownership home – commensurate with their respective ownership shares.

- **Recommendation 5**: In order to drive homeownership to the 500,000 mark and address the unfairness around price discounts, Government and housing associations should consider a new Right to Part-Buy (RTPB). This would give a social tenant the right to buy a share of their home with exactly the same percentage discount as their Right to Buy.

The main benefit of such a policy is that it would enable many more of the 1.4m eligible housing association households to access homeownership than the estimated additional 170,000 to 221,000 through the Right to Buy extension policy. This would include many of those who expect to buy but who cannot – including the 319,000 housing association tenants who only expect to buy beyond 5 years from now. The Right to Part Buy offer is also likely to appeal to many housing association social tenants living in London and the South East wanting to buy. High house prices in the capital mean that the plain vanilla Right to Buy is beyond the reach of many, even with its generous discount and higher discount cap.

A key policy problem is who would fund the Right to Part Buy discounts. Under the Right to Buy extension voluntary agreement between Government and the sector last Autumn, housing associations agreed voluntarily to extend the right to buy to their social tenants on the condition that Government fully compensated them for the discounts. Without such compensation, housing associations stood to lose up to £11.6bn in social housing assets, according to the National Housing Federation. This depletion of their rented housing stock and the associated rental income stream would also have reduced their borrowing capacity to build new housing. The Government eventually agreed to fully compensate housing associations as part of the voluntary deal (VRTB).

Assuming there are 221,000 RTB extension sales, an additional 279,000 Right to Part Buy sales would be enough additional sales to reach the 500,000 total.

Assuming 279,000 social tenants buy, say, a 50% share of their social home on average at the some percentage discount, a Right to Part Buy policy backed by full Government compensation of housing associations would cost in the order of £7.3bn but could be entirely scalable to match the Government's ambition. In addition to the £11.6bn cost of the current extension policy, this would bring the total cost of the Right to Buy / Right to Part Buy policy to £18.9bn. If there were 500,000 RTB and RTPB sales over 20 years (10,000 RTB and 15,000 RTPB), that would mean an Exchequer cost just under £1bn a year.

- **Recommendation 6**: Following in the footsteps of the right to buy extension voluntary agreement, Government should fully compensate housing associations for the proposed Right to Part-Buy, as well as continue to fully compensate them for the (V) Right to Buy.

2.3 Which housing association households should own?

Clearly, very careful consideration needs to be given to the suitability of homeownership for the different types of housing association households. Homeownership is less likely to be suitable for households that are wholly dependent on welfare benefits – as well as especially vulnerable households (there is a high overlap between the two). Homeownership is likely to be most suitable for those housing association households with higher incomes – with a strong correlation to those where the head of household is in full time work. There is also a strong public policy case to use the Right to Buy / Part Buy as a policy measure to support work incentives - to enter work or to stay in work. This also sits well with the charitable objective of many traditional housing associations to support households into work.

There are nearly 600,000 (586,000) housing association households (around 1 in 4) where the head of household is in full time work – presumably earning at least the national minimum wage, now £7.20 an hour, or an annual income of nearly £15,000 assuming a 40 hour working week. There are a further 262,000 housing association households where the head of household is in part time work, some of whom might be encouraged to move into full time work at some point and with the right support or work incentives. Many of those in part time work particularly will be in receipt of Housing Benefit: around 264,000 housing association tenants that work *full time or part time* are in receipt of Housing Benefit. The other pertinent issue is that a significant number of those in low paid work and on the margins of the labour market tend to 'cycle' between periods of work and periods out of work. Those earning the minimum wage and who are often out of work (e.g. more than one month a year during each of the last three years, say) are unlikely to be suitable for homeownership.

Table 2.2: Minimum notional income levels for full time working households, by household type

	Single adult, in full time work	Couple with no children, one partner in full time work	Lone parent in full time work, one child	Couple with two children, one partner in full time work
Earnings @national minimum wage				£14,976
Working Tax Credit	0	£1,264	£1,264	£1,264
Child Tax Credit	Not eligible	Not eligible	£3,329	£6,110
Total income (notional)*	£14,976	£16,241	£19,570	£22,170

**Excluding any benefits such as Housing Benefit, with no disabled household members*

We consider household incomes for four household types on the basis they are in full time work: one single adult, a couple with no children (where one partner is in full time work), a lone parent with one child, and a couple with two children (where one partner is full time work). Table 2.1 shows total household income levels excluding Housing Benefit on the basis they earn the National Minimum Wage. We exclude Housing Benefit because households would lose entitlement to this upon exercising their Right to Buy:

How do these notional income levels and the implied affordable Right to Buy prices compare to the actual household incomes and prices we observe? The notional incomes estimated above range from just shy of £15,000 a year to £22,000 a year, and appear broadly situated around the mean average income levels of housing association households (see table below). The mean average usually falls around the 60 percentile level in a typical income distribution with a positive skew. Significant regional variation in mean average income levels, from just shy of 15,000 in the North East to £18,500 in the South East, is interesting given the amounts exclude Housing Benefit, the benefit most likely to vary by region. Wages are likely to vary much more by region: not just according to the average hourly rate but by labour market participation rates and labour market conditions more generally. So this could indicate a significant wage component of household incomes at the mean average level.

Table 2.2: Annual Income of Housing Association Households (ex Housing Benefit), 2013/14[29]

	Mean average income of Head of household + Partner	Mean average income of household (all adults)
	Housing association households only	Housing association households only
North East	**£14,972**	£16,054
North West	**£15,198**	£17,147
Yorkshire	**£15,269**	£17,039
East Midlands	**£15,306**	£16,300
West Midlands	**£15,047**	£17,015
East	**£16,987**	£18,542
London	**£17,575**	£21,132
South East	**£18,442**	£20,856
South west	**£16,284**	£18,107
ENGLAND	**£16,291**	£18,384

29 English Housing Survey 2013/14 data extract. Data obtained from DCLG.

So could housing association households with a mean average income afford their Right to Buy on a region by region basis? And if so would they actually be better off doing so than remaining as social tenants paying the average housing association rent (mostly social rent)?

The National Housing Federation's analysis assumed an attainable mortgage of 3.5 times household income and a 5% deposit. A regional analysis on this basis broadly conveys that those with the mean average *housing association* household income could afford the average Right to Buy home in 6 of 9 English regions apart from London, the South East and East of England. So in these three regions, affordability constraints are much more likely to impair Right to Buy take up rates, unless such factors as the 'bank of son and daughter' come significantly into play (which they often do).

Table 2.3: Affordability of RTB for the average income housing association household, by Region

	Average household income	Average RTB sale price[30]*	RTB broadly attainable?	Weekly rent	Weekly mortgage payment**	Better off?
North East	£14,972	£37,609	Yes	£78.52	£39.46	Yes
North West	£15,198	£39,440	Yes	£83.74	£41.38	Yes
Yorkshire	£15,269	£40,981	Yes	£91.56	£42.99	Yes
East Midlands	£15,306	£42,713	Yes	£88.75	£44.81	Yes
West Midlands	£15,047	£50,226	Yes	£89.45	£52.69	Yes
East England	£16,987	£88,556	No	£98.48	£92.91	Yes
London	£17,575	£104,788	No	£131.02	£109.94	Yes
South East	£18,442	£81,454	No	£109.54	£85.46	Yes
South West	£16,284	£62,605	Yes	£90.75	£65.68	Yes
ENGLAND	£16,291	£68,818	(no)	£98.11	£72.20	Yes

**Assumes a 50% RTB discount*
***Assumes a 25 year repayment mortgage at 3% mortgage interest, 5% deposit*

It is in London, and the South East of East of England, therefore, that the Right to <u>Part</u> Buy is likely to be far more attainable for housing association households than the plain vanilla Right to Buy. The Right to Part Buy could therefore make a real difference to take up rates in these parts of the country. There are, for example, 363,000 social tenant housing association households London alone (1,910,000 in the rest of England).

This is also important because the table conveys that households would generally be better off paying a mortgage at current mortgage interest rates than paying average housing association rents. But low interest rates won't last forever, underlying the importance of locking in low mortgage interest payments, perhaps by encouraging 5 year fixed rate deals.

- **Recommendation 7**: Those exercising their Right to Buy should be encouraged to lock in current low interest rates by taking out a minimum 5 year fixed rate mortgage. This could be part of the eligibility criteria for a new Homeownership Allowance (proposed below).

However, the better off figures above assume implicitly that Housing Benefit is not in payment (and hence not lost through RTB), though this is

30 Average RTB sale price data from LAHS data retuen 2013/14. RTB sale prices are generally higher than PRTB sale prices which may reflect a poorer condition on transferred stock.

likely to be true of many households in full time work paying social rents. More importantly, it also abstracts from maintenance and major repair costs. For instance, the average cost of routine and planned maintenance and major repairs for a housing association home in 2014/15 was £1,017 and £929 respectively, or £1,946 in total.[31] This works out at £37 per week. Assuming simplistically that housing associations continued to provide but not pay for maintenance and repairs services to RTB households, and charged these households the full amount at cost (i.e. £37 per week), households exercising their RTB in the four southern regions would be worse off as a result – from £12 in the south West, £13 a week in the South East, £15 in London, to £32 a week in the East of England.

There is a public policy case for Government providing a Homeownership Allowance to cover a proportion of the maintenance and repairs costs for households exercising their Right to Buy, at least for the first 2 years while mortgage costs as a percentage of income is higher. This revolves around boosting work incentives especially for those in part time work caught in the poverty trap. There is also the potential Housing Benefit savings accruing to Government from those exercising their Right to Buy. The official 2012 Right to Buy Impact Assessment highlighted evidence that around 10% of households then exercising their right to buy were previously on Housing Benefit.[32] This was also evidence of the bank of son and daughter effect on right to buy sales. The average amount of housing benefit received by social housing tenants in receipt of the benefit is £80 a week[33], which is likely to be similar across council and housing association tenants. However, there would be significant 'deadweight' associated with a Homeownership Allowance which would increase the case for it to be means tested which, in turn, would reduce the work incentive effects.

- **Recommendation 8**: To further underpin homeownership sustainability, Government should introduce a Homeownership Allowance for those exercising their Right to Buy payable for their first 2 years of homeowership, to help cover their home maintenance and repairs costs. A £15 a week allowance - possibly as a tax credit and paid at a fixed national rate, would be enough make a real difference.

Finally, it is worth adding that a significant take up of Right to Buy or Right to Part Buy amongst housing association households – in the order of 500,000 households and over, say, a period of 25 years or so - would shift the role of the housing association further away from being the traditional social landlord. Indeed, instead of a housing association getting the mainstay of income from rental income, it would derive an increasing amount of revenue from other sources. These include Right to Buy and Right to Part Buy sale proceeds, converting an increasing proportion of existing social and affordable rented homes into shared ownership ones with subsequent staircasing receipts, and from broader asset churn (as well as building for market sale). In similar vein, housing associations could (and should) act as routine maintenance and major repairs service providers for homeowners - in much the same way they have always done for social housing tenants - as a new income stream.

31 Homes & Communities Agency, Global Accounts of Housing Providers (2015)

32 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/8423/2102753.pdf

33 English Housing Survey 2014/15

Chapter 3: Housing Association Sector Consolidation

3.1 Why the sector should consolidate

There are over 1,500 housing associations in the sector. Many, both inside and outside the sector, feel this is too many and that some degree of consolidation is necessary, though the desired extent of consolidation remains debated. But consolidation is only a means to an end. Ultimately consolidation is seen as a way to both drive sector wide efficiencies (rightly or wrongly) and to further re-orientate the sector to home building.

Efficiency is about containing and reducing costs, noting the wide and sometimes opaque variation in unit costs from one housing association to the next and explored later in this chapter. Driving efficiencies can be done at two levels – continuing to drive efficiencies across the board (e.g. through innovation) as well as 'exiting' organisations which are highly inefficient, including through consolidation (merger and/or amalgamation). Notwithstanding, greater efficiency is a means to an end – the three prizes include:

i larger surplus positions and in turn borrowing and home building capacity;
ii improved services for housing association households; and
iii the containment of rents and Housing Benefit expenditure.

The other important consideration in re-orientating the sector further to house building is housing associations spending proportionately less money on activity that is not house building. This stems from an opportunity cost argument (spending money on 'x' is not spending it on house building, an opportunity cost of 'y' number of homes not built).

3.2 Sector consolidation in recent years

There has been significant sector consolidation in recent years, with 230 housing associations involved in becoming part of a group structure or an amalgamation - a full 'merger' - over the last 7 years (see table 3.1). However, it would take another 30 years at the current rate for the number of organisations in the sector to halve.

In the commercial sector, an indication of a high degree of competition is a high number of new entrants (i.e. a lack of barriers to entry) and, equally important, a high level of exits (including mergers and acquisitions). The very high number of housing associations and the low level of housing association exits in particular indicates that, much like any extensively charitable sector, the housing association sector has a relatively low level of intra-sector competition.

Table 3.1: Housing association mergers 2009/10 to 2015/16[34]

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Constitutional consents creating a group	8	16	11	8	8	5	12
ToE consents	21	31	22	8	4	14	18
Amalgamation consents (individual)[35]	0	0	19	10	4	8	3
Total	**29**	**47**	**52**	**26**	**16**	**27**	**33**

It is undoubtedly true that merger and acquisition in the housing association sector is far more difficult than it is in the commercial sector. And politically it would be unthinkable to let a housing association fail, which can also give rise to moral hazard issues (the 'too big to fail' argument, but in a political rather than an economic sense). A housing association cannot, for example, be the subject of a "hostile" takeover by another housing association, because housing association shares cannot be traded.

For a housing association to be taken over, its shareholders have to agree it; generally on the basis of a recommendation from its Board. Often a board will reject such an approach on legitimate grounds, including to protect the interest of its tenants. But sometimes a takeover would not be in the self-interest of the existing Board or Executive: an incumbent CEO with a generous salary and final salary pension, for example, would have little incentive to 'move on'. That, of course, is not necessarily a problem if the CEO concerned is at the helm of an efficient organisation, but what if he or she is not?

3.3 The case for 'bigger is better'

Whilst it is certainly true is that bigger isn't always better – at the extreme, monopoly power is not a desirable outcome - there are a number of reasons why bigger organisations can be better in terms of house building output and efficiencies. These are explored below.

House building

A housing association sector more oriented to house building is likely to require that its constituent organisations are of a certain size in order for them to build efficiently: those building themselves 'in-house' probably need the financial capacity from owning / managing many thousands of homes to be able to do this efficiently. Currently there is a group of 50 or so developing housing associations, namely the largest with 10,000 homes or more.

Recent high profile 'super mergers' – L&Q with East Thames[36], Affinity Sutton with Circle, Sovereign with Spectrum – are all predicated largely on ramping up house building capacity. They will all create single organisations each with a housing stock of 50,000 or more.

The new Affinity Sutton entity will have a housing stock of 127,000 and it is claimed will build 5,000 homes a year – broadly a doubling of what that they were building under the status quo. Of course, whether these increased home building levels will be achieved remains uncertain, but they are firm aspirations.

Logically, bigger organisations should be able to build more (proportionately)

34 Data obtained from the Homes and Communities Agency. Figures for 2015/16 exclude ongoing consent applications.

35 Each provider is issued with a consent, so the actual number of amalgamations will be at least half of this.

36 Hyde has subsequently withdrawn from the proposed merger, at the time of writing.

because they have the critical mass required for a development programme and the associated management of it. Particularly, they:

1. can harness economies of scale around cost, for example by creating efficiencies through merged back-office functions and combined purchasing power
2. can make the substantial upfront fixed investment to create / augment planning and development operations across the entire pipeline (absolving the need to commission a separate house builder)
3. can provide more balance sheet clout and resilience as well as risk management
4. can exercise a greater level of strategic control over where they build (i.e. where homes are needed the most) and across different local authority boundaries
5. have greater bargaining power when negotiating with local authorities (e.g. land)

But do bigger housing associations actually build more, including when commissioned building is taken into account? The Policy Exchange Top 60 housing associations in chapter 1 ranks housing associations (or housing association groups[37]) by their affordable home building rate. It contains housing associations of many different sizes, measured by the housing stock they manage, from 1,200 homes to 50,000 homes with many sizes in between. The average size of the Top 60 was around 11,000, the same as the sector average for the subset of 240 housing associations (or housing association groups) with a stock > 1,000 reported in the HCA's Global Accounts.

However, this actually says very little about the correlation between the size of organisation and build rate. To do that, Table 3.2 ranks the 240 housing associations (or housing association groups) with a managed housing stock greater than 1,000. It then ranks them by size from smallest to largest, alongside the number of affordable homes they built. It then splits them into quintile by size (i.e. 5 groups of 48, from smallest 48 to biggest 48):

Table 3.2: Housing associations ranked by size (quintile group) and home building rate, 2014/15[38]

	1st quintile (Smallest20%)	2nd quintile	3rd quintile (middle 20%)	4th quintile	5th quintile (biggest20%)
Number of HAs	48	48	48	48	48
Average no homes managed	1,800	4,000	6,500	12,000	30,800
Average number of homes built	24	65	110	220	550
Home building rate	**+1.45%**	**+1.64%**	**+1.72%**	**+1.79%**	**+1.81%**

These numbers suggest that average build rates rise as we ascend up the quintile groups, from 1.45% for the smallest 48 housing associations (or housing

37 In the Global accounts 332 housing associations with a stock > 1000 homes are listed. But many of these are part of 'Group'. For example, Orbit Group Limited and Orbit South Housing Association Limited (as well as Heart of England Housing Association) are listed individually in the Global Accounts, but are all part of Orbit Group Limited. Counted this way, there are 240 housing associations or housing association groups.

38 Raw data obtained from Homes & Communities Agency, Global Accounts of Housing Providers (2015) [Spreadsheet Data]

association groups) to 1.81% for the largest 48. In particular, the smallest 48 housing associations have a noticeably lower build rate (1.45%) than the next smallest 48 (1.64%) – the latter has an average stock size of 4,000 homes which we posit as an important size threshold for building. However, the numbers also suggest that the build rate does not increase with stock size much beyond the 4th quintile of housing associations which, seen within the context of the whole, suggests that bigger is better but only to a point. The implication is that we need to see the most sector consolidation in the 1st quintile and consolidation across it rather than just at the very top – i.e. not just the super mergers.[39]

The following case study (box 3.1) shows how a merger can create a financially stronger single organisation that is both better able to meet its social purpose objectives, achieve better tenant satisfaction, as well as deliver increased house building. That is, the efficiency gains mean these are not necessarily mutually exclusive.

Box 3.1: Merger case study; The Riverside Housing Group

Background
Merger date: 2006. Organisations involved:

- **The Riverside Group Ltd (TRGL)** a Liverpool-based organisation based in the North West and East Midlands with a social housing stock of 36,000 homes. With Merseyside origins going back to 1928, it was originally a traditional housing association. It grew from the late 1980s through a series of stock transfers as well as organic growth through new development.
- **English Churches Housing Group (ECHG)** a Leicester-based organisation with a significant geographical footprint (100+ local authorities) extending from Kent to Northumberland with a social housing stock of 11,500 homes. With church roots it specialised in the provision of supported (homeless) and sheltered housing.

These were brought into a group structure and later amalgamated into a single entity **The Riverside Group Ltd.**

Reason for merger
The origins of the merger lay in financial problems at ECHG – Riverside was approached by the Regulator and selected to rescue ECHG. Without a merger ECHG would not have been viable longer term and was already facing a 10-year cumulative deficit of £70m. Nor would it have been able to address the longer term investment needs of its housing stock. However, for Riverside the merger was also about it growing outside a constrained geographical footprint as well as to grow its supported housing business. This established it as an expert provider and put its supported housing business on a more sustainable footing.

Merger outcomes
The overall post-merger organisation created two distinct businesses in the same amalgamated entity: (1) A general needs housing and (ii) a supported housing business. Since the merger:

- Riverside is a financially secure and strong organisation, one of only three housing associations rated AA3 by Moody's
- House building output has increased significantly
- Customer satisfaction ratings have much improved– for formerly ECHG tenants this increased from 47% in 2007 to 85% in 2015

39 This analysis also does not adjust for supported housing providers.

Riverside's pre and post-merger key metrics:

	Old organisation 'A' TRGL 2005/06	Old organisation 'B' ECHG 2005/06	Merged organisation 2007/08	Merged organisation 2014/15
No homes	40,579	11,540	52,339	53,164
Employees	1,006	1,067	2,198	2,695
Total revenues	£124m	£79m	£247m	£321m
Total costs	£109m	£79m	£234m	£276m
Surplus	£14m	negl.	£13m	£45m
Homes built	331	86	200	827

Efficiency

Are bigger housing associations more efficient and do they have lower costs? In a recent major study, *Delivering Value for Money: Understanding Differences in Unit Costs*[40] , the Regulator found no clear link between the size of a housing association and its costs - i.e. no [statistically] significant relationship. The Regulator's analysis found that three main factors affect a housing association's costs: its amount of supported housing and housing for older people; regional wages; and costs associated with stock transfers (i.e. the required investment to improve the stock that has been transferred from the council).

The report noted a wide variation in unit costs from one housing association to the next – average unit costs were found to be £3,550 compared to £3,200 in the lower (cost) quartile and £4,300 in the upper (cost) quartile, with a minority of housing associations with significant supported housing with unit costs of £10,000 or more. However, only 50% of the variation in unit costs could be explained by the cost factors described. Julian Ashby, Chair of the HCA's Regulation Committee, said in a letter to Chairs that this level of unexplained cost variation must at least in part be due to differences in efficiency.

As context, a £350 reduction in the cost per home across the sector, from the average cost to the lowest quartile cost, would save / increase its aggregate surplus by nearly £1bn. Delivering half of that (i.e. the unexplained bit) implies a sector saving / surplus increase of £500m. That is a substantial amount of money. If it was invested with a prudent amount of leverage (borrowing at 60% LTV), it would be enough to build an extra 8,000 homes a year.

Boxes 3.2 and 3.3 (overleaf)- demonstrate how amalgamations ('group rationalisations') to create single larger organisations, away from group structures of smaller organisations, can create efficiencies in a number of ways.

40 https://www.gov.uk/government/publications/delivering-better-value-for-money-understanding-differences-in-unit-costs

Box 3.2: Amalgamation case study; Genesis Housing Association

Background
Group rationalisation date: 2011. The groups involved:

Genesis Housing Group | Paddington Churches Housing Association | Springboard& Pathmeads
These groups were folded into the single entity **Genesis Housing Association.**

Reason for group rationalisation
The Group structure was too complex. Each organisation within the Group had its own Board and committees, decision-making was unwieldy and overly bureaucratic. There was insufficient alignment between the separate organisations on corporate strategy and cohering key strategies. Amalgamation was the obvious way to achieve business efficiency, and reduce operational costs. It also released build housing capacity enabling quicker and more effective delivery mechanisms – instead of several organisations developing a pipeline; the new single organisation had its own which could be effectively implemented.

Group rationalisation outcomes
Reduced operational costs were a high point of the move – as part of the post-merger Genesis Way Programme which sought to embed those operational efficiencies, £20 million of savings were achieved including:

£4.3m people efficiencies | £2.5m procurement efficiencies | £2.5m office space

Box 3.3: Amalgamation case study; Sovereign Housing Association

Background
Group rationalisation date: 2010 and 2011. The groups involved:

Sovereign Housing Group | The Vale Housing Association | Kingfisher H.A. | Twynham H.A.
These groups were folded into the single entity **Sovereign Housing Association.**

Reason for group rationalisation
First, it brought about much clarity and efficiency in the governance and communications functions. Second, it brought the 4 separate housing associations together so the new single organisation with a collective identity and consistent approach to service delivery.

Group rationalisation outcomes

- Sovereign owns 5,061 more homes (it manages 5,527 more), growth achieved at the same time as disposals in outlying areas.
- A reduced ratio of staff to property (operating costs are also lower), even though staff numbers are now similar to pre-rationalisation levels

Turnover has increased by over £38.5m, but operating costs by less than £18m, which has contributed to the significantly increased surplus of £72.4m in 2015 (£48.6m before)

Particularly, group structures can be complex with multiple boards that are not always aligned in their strategic objectives, resulting in the lack of a coherent corporate strategy and slower decision making. There can also be a duplication of functions reducing overall cost effectiveness. Forming a group structure is often a precursor to amalgamation.

What the future sector structure should look like

Broadly the sector today could be viewed as having 4 tiers: the very large housing associations (over 10,000 homes), the medium sized housing associations (1,000 to 9,999 homes), the small (250 to 1,000 homes) and the tiny (under 250) -

most likely to be Almshouses. The sector currently contains around 1,500 housing associations:

- 240 housing associations or housing association groups manage 1,000 homes or more accounting for 96% of the sector's housing stock
- 74 manage 10,000 homes or more accounting for the majority of the sector's stock[41]
- ~1,200 form a long tail of housing associations managing fewer than 1,000 homes, the majority fewer than 250 homes, accounting for 4% of the sector's housing stock.

A consolidated sector oriented more towards house building would contain predominantly housing associations managing 4,000 homes or more, recalling the marked decline in build rates amongst smaller housing associations reported in table 3.2.

But how could we arrive at such a sector structure, one more able to build the homes we need? Firstly, consolidation should probably not involve the very small organisations of few than 1,000 homes, if anything for reasons of practicality. At the corporate level, taking over a small organisation often entails as much 'leg work' as taking over a large – the cost/reward equation will often make it not worthwhile for an acquiring housing association. At the sector level, these 1,200 organisations only manage 4% of the sector's housing stock, which loosely translates to 4% of the sector's house building capacity.

- **Recommendation 9**: The ~1,200 small organisations with fewer than 1,000 homes – and certainly the Almhouses - should be deregulated entirely and taken out of the Regulator's control, placing them back under the auspices of the Charities Commission.

This would leave the sector with the 240 housing associations (or housing association groups) with a stock of 1,000 homes or more under the auspices of the Regulator.

Secondly, and again with table 3.2 in mind, we actually need to see most consolidation amongst the 'middle-sized' housing associations managing 1,000 to 4,000 homes. If each of the 48 housing associations in the bottom quintile merged, the number of housing associations in the sector by would be reduced at least 24 organisations. This figure could be far higher when we add mergers involving two or more organisations as well as those across the rest of the sector including the super mergers - easily as many as 50. This implies a future housing association sector with fewer than 200 housing associations (or housing association groups) managing an average of 13,000+ homes.

- **Recommendation 10**: To help encourage consolidation, as well as to keep the number of proposed Housing Deals manageable, only housing associations with a stock of 4,000 homes or more (or consortia / groups of smaller housing associations that have a combined stock of 4,000 homes) should be eligible for a Housing Deal

41 Homes & Communities Agency, Global Accounts of Housing Providers (2015)

Chapter 4: A New Settlement

4.1 The New Settlement Concept

This report proposes a New Settlement between Government and independent housing associations: one of housing association responsibilities, freedoms and flexibilities and of greater self-regulation, to support the commonality of interest of Government and many housing associations - to build many more homes and promote homeownership amongst lower income households.

The proposed New Settlement construct is a set of voluntary Housing Deals between Government and individual housing associations, similar in concept to the City Deals and possibly, like the City Deals, conducted in waves.

The City Deal gives the city and its surrounding area certain powers and freedom to:

- Take charge and responsibility of decisions that affect their area
- Do what they think is best to help businesses grow
- Create economic growth
- Decide how public money should be spent
- The Housing Deal will give the housing association certain powers and freedom to:
- Be in charge of their own destiny
- Do what they think is best to support their households to live independently
- Create housing growth and extend homeownership to their tenants
- Decide how public money, and their own money, should be spent

Each Housing Deal would be different but the Government would control the number of Housing Deals it wanted, at least initially to manage demand and risk. Housing Deals would be time-limited – perhaps 5 years. A housing association signing up to a Housing Deal would have to demonstrate progress against their commitments in their annual reporting.

The recommendations forming the genetic make-up of Housing Deals are contained throughout this report. They are the commitments given by Government and a housing association set out in the Housing Deal, to support the high-level outcome-based objectives of more home building and promoting home ownership, as well as sector consolidation to support these (and other) outcomes.

The New Settlement's Housing Deal 'blueprint' would be the template for Housing Deals and would inform the parameters of individual housing association negotiations. The centrepiece of any Housing Deal would be the housing association's commitment to build a certain number of homes (a building rate set in relation to its housing stock). The Government would commit to provide a combination of financial support and grant regulatory freedoms to help the housing association deliver on this and its other outcome based commitments.

To support sector consolidation, Housing Deals would only be offered to larger housing associations that own or manage a stock of more than 4,000 homes (or consortia / groups of smaller housing associations that have a combined stock of 4,000 homes).

4.2 The Housing Deal blueprint

Although each Housing Deal will be unique to the Housing Association signing up to it, the Housing Deal blueprint is a template which will inform the parameters of the negotiation. The curly brackets { } are negotiated and depend on the individual housing association concerned: the figures will and vary from one Housing Deal to another.

Box 4.1 illustrates what a basic Housing Deal blueprint could look like.

Box 4.1: The Housing Deal Blueprint

More home building:

The housing association will:
Use their surplus positions and the leverage it brings to increase the number of homes they build, by committing to:

- a {3% to 4%}* building rate each year, building a mix of affordable and market homes [recommendation 1], supported where necessary by 'borrow to build' [recommendation 2];
- build a 'mixed economy' of housing with significant number of shared ownership homes that make up {x%} of their affordable housing offer and a significant number of market homes for rent or sale; and
- offer {number} of their existing social tenants eligible for the Right to Buy the <u>Portable</u> Right to Buy for a new build home, to support an expanded 'home building for open market sale' programme [recommendation 4]

Government will:
Support the housing association to finance its expanded home building programme by:

- agreeing a social rent envelope for the housing association, where the housing association's social and affordable rents are allowed to rise between {0% and CPI%} per annum [recommendation 3];
- providing {£ amount} of Affordable Housing Guarantees [recommendation 3];
- providing {£ amount} of grant funding for the shared ownership homes following the Spending Review 2015; and
- {fully / partially} compensating the housing association for the proposed Portable Right to Buy discount

Promoting home ownership:

The housing association will:
Promote sustainable homeownership and support work incentives amongst its social housing tenants, moving significantly beyond the Voluntary Right to Buy extension, by:

- committing {fully / partially} to a new voluntary Right to <u>Part</u>-Buy, giving their social tenants the right to buy a *share* of their home with exactly the same percentage discount as their Right to Buy (recommendation 5)
- offering maintenance / repair services to its households exercising their Right to Buy / Right to <u>Part</u> Buy {at cost} for a period of {2-5} years (recommendation 7)
- paying their fair share of essential maintenance and repairs costs of their Right to <u>Part</u> Buy shared ownership homes, pro-rated to their ownership share
- providing a 'reverse staircase' mechanism (i.e. buying ownership shares back from the Right to Part Buy household), if the household runs into financial difficulty, as a measure of last resort. This would require repaying the Government the compensation it provided for the Right to Part Buy discount.

Government will:
Support the housing association to expand homeownership sustainably by providing additional financial support to them and their social housing tenants, by:

- {fully/partially} compensating the housing association for the proposed Voluntary Right to <u>Part</u>-Buy (recommendation 6)
- introducing the new Homeownership Allowance for those exercising their Right to Buy, payable for their first 2 years of homeownership, to help cover their home maintenance and repairs costs, at £15 a week (recommendation 7)
- restrict eligibility for the Homeownership Allowance to Right to Buyers with a minimum 5 year fixed rate mortgage (recommendation 8)
- impose in work eligibility criteria for the Homeownership Allowance

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