House of Commons

Communities and Local Government Committee

# Financing of new housing supply

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### *Volume II*

*Additional written evidence*

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# Written evidence

## Written submission from David Holliday

If Housing Act 1985 Part X Overcrowding is repealed there will be a need for an additional 600,000 dwellings on the adoption of Housing Act 2004 Part 1 "crowding and space, bedroom standard".

This figure has been with me for a few years.

Few people would argue that statutory overcrowding provisions need revision now that overcrowded dwellings are so prevalent.

I do not intend to add opinion to financing new housing; formerly slum clearance schemes released land for development. Criteria like: having a WC entered externally from the house are no use now, but terraces of urban houses with less than four storeys could be fair game for clearance, and development involving six storey properties.

I don't want to see this, I'm 60 years old.

Local planning authority should be able to retain some of the original housing, though often more than 100 years old, still tenable.

Housing Health and Safety Rating System (Version 2) provides a précis of crowding and space.

*October 2011*

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## Written submission from the Coalition for Economic Justice (CEJ)

### 1. The Coalition for Economic Justice (CEJ)

Organisations that make up the CEJ are concerned with:

- fair, efficient and effective taxation;
- the collection of natural resource rent to pay for public expenditure and to replace those taxes that are unfair, avoidable and/or which act as a drag anchor on the economy;
- policies that ensure the efficient use of the UK's and the world's natural resources; and
- policies that enable the provision of affordable homes, affordable business premises and which stimulate the sustainable production of goods and services.

The CEJ has no political party allegiance though some of its member organisations do.

### 2. Summary of CEJ's Response

The true economic value of each site (the economic rent) is the surplus income the site can produce in excess of the market-determined rewards to suppliers of things made and services used in the process of production.

- With particular regard to funding housing supply the CEJ recognises there are two distinct elements that make up the cost of housing provision:
  - (I) the cost of constructing and maintaining the *building* itself; and
  - (II) the cost of the *land* (ie the site or "location") each building occupies.
- The cost of constructing or maintaining a building does not vary to any great extent across the country; there may be marginal differences in wage levels *and purchasing building materials* but these are insignificant compared to the variable cost of the land. However, the cost of purchasing or renting land does vary considerably according to each site's location. Buildings deteriorate and lose value as normally happens with anything made by human effort.
- Land is a natural resource and is of fixed supply with no cost of production. *Some locations are naturally more attractive or desirable than other locations and this is reflected in land values.* But, the value of a particular site naturally increases as population grows, local services improve or the productivity of a site is increased by improved techniques such as new technology or labour-saving methodology. In addition, the selling price of a site can be subtly inflated by sellers who demand a price higher than the current value in anticipation of future land value increases (hope value) and by land speculators keeping buildings empty and sites idle thus creating an artificial shortage of land and hence a fabricated increased scarcity value.

— The true *economic value* of each site (the economic rent) is determined by the surplus income that a site can produce in relation to a marginal site with no surplus income. The surplus income of a site is measured by deducting all the costs of production from the total income that the site produces. The cost of production includes wages, raw materials, machinery, computers, buildings, tools, transport costs, essential expenses, bank charges and a "reasonable" profit. Where these are in balance, the site will be used to produce wealth. Where the costs of production are greater than income, the site will be below the margin and will remain unused and jobs and homes will disappear. However, the greater the surplus of income over production costs, the greater the annual economic rent of the site. This surplus is clearly not a cost of production but a windfall for the economy which is currently collected by landowners.

— However, taxes on wages and trade increase the cost of production, reducing the rent surplus and force some sites that could produce without taxes below the margin—creating unnecessary unemployment.

— As local economies flourish around a site, so the surplus income—the rent—increases and landowners take that surplus as their unearned income.

— The CEJ argues that the rent of land is created by society's combined economic effort and not by owners of land and therefore should be collected by government to pay for the cost of running and improving public services.[1] By collecting at least some land rent from landowners, government has the opportunity to abolish or reduce those taxes that stifle positive economic growth and cause unemployment and poverty.

— The CEJ and others who examine the economic effects of privatised land rent predicted the current financial crisis would occur due to speculation in land causing a property bubble encouraged by the banks unfettered lending to speculators.[2]

— The CEJ asserts the economy will inevitably be subject to regular and predictable economic booms and busts so long as the economic rental value of land (and of other natural resources) continues to go to private owners instead of being used as a positive form of taxation.

## 3. CEJ Recommendation

In response to this consultation on funding housing, the CEJ therefore advocates the shifting of current property taxes off buildings and on to each site's annual rental value according to its optimum permitted use by abolishing current property taxes (National Non-Domestic Rates, Council Tax and Stamp Duty Land Tax) and introducing an annual Land Value Tax on all land thereby:

— acting as an economic incentive for property owners to bring empty and underused sites into full use;

— increasing the supply of building land for sale rather than it being held out of use for speculative purposes;

— reducing the opportunity for land owners to exploit public investment into projects that require the purchase of land by increasing land prices above its true economic value;

— reducing the need for "urban sprawl" on to green land with the wastefulness of commuting; and

— ensuring grants provided to business or organisations are used for the purpose intended rather than being leached into land values[3] and therefore being diverted to land owners as happens at present.

## 4. CEJ's Response to Issues Set out in the Consultation Paper

(I) *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

The CEJ asserts that under the present system of taxation, any public subsidy or grant will ultimately increase the rental value of the land, by the same amount as the grant or subsidy.[4] This effect has been observed over the years by economists where subsidies are granted to farmers under the Common Agricultural Policy; rate free periods and grants given in previous Enterprise Zones; higher house prices where domestic rates were kept low (and vice versa—lower house prices where high domestic rates were applied) and with other grants and subsidies.

Grants and subsidies will eventually be capitalised into land prices and are not an effective means of financing social housing and two sources in support of this statement are:

(a) The Centre for European Policy Studies (CEPS) Study on the Functioning of Land Markets in the EU Member States under the Influence of Measures Applied under the Common Agricultural Policy states "Economic theory, as well as empirical findings, suggest that the way in which agricultural support is provided has an influence on land markets, because payments capitalise to some degree into land values, affecting both the sale and rental price of land."

[1] See David Ricardo's theory of Economic Rent.

[2] See "Power in the Land" 1983 and "Boom and Bust" 2005, by Fred Harrison.

[3] Centre for European Policy Studies (CEPS) Study on the Functioning of Land Markets in the EU Member States under the Influence of Measures Applied under the Common Agricultural Policy.

[4] For explanation see Ricardo's theory of Economic Rent.

(b) In their publication "Capitalization of Central Government Grants into Local House Prices: Panel Data Evidence from England (Version: August 26, 2010)", the authors—Christian A L Hilber, LSE & SERC; Teemu Lyytikäinen, LSE & SERC and Wouter Vermeulen, CPB Netherlands Bureau for Economic Policy Analysis, VU University and SERC—state "we explore the impact of central government grants on local house prices in England using a panel data set of local authorities (LAs) from 2001 to 2008. Electoral targeting of grants to LAs by the incumbent national government provides an exogenous source of variation in grants that we exploit to identify their causal effect on house prices. Our results indicate substantial or even full capitalization. ... Our findings imply that the possible crime prevention effects or lower taxes would increase house prices and rents in inner cities, which are largely populated by renters. Beneficiaries of the change are (the few) homeowners as well as landlords who own most of the inner city properties. Private renters would likely not benefit from the additional funding because they pay via higher rents for the benefits of the grant increase. Social renters may benefit to the extent that the grant increase does not affect their rents."

The CEJ therefore concludes that until at least part of the economic rent of land is collected by government, any subsidy or grant will always divert to landowners in increased rents or higher land prices; this fundamental fault with economic understanding must be corrected to ensure all capital and revenue public subsidy is used in the funding of homes.

Once the economic rent of land is collected by government, then all of the limited capital and revenue public subsidy can best be applied to projects where the land concerned is owned by not-for-profit organisations including housing associations, housing co-operatives, community land trusts. By allocating any subsidy to non profit making bodies, any surplus income will thereby be ploughed back into maintaining those projects and/or enabling further investments in other housing projects.

### CEJ Response to Issues (II) to (VII)

The CEJ reasserts that whichever path of financing housing the government chooses, unless the land issue is addressed, all government expenditure will be capitalised in land values and therefore in land costs. If the decision is for local authority housing to be self funding, then the higher land costs will mean higher rents being paid by tenants.

*October 2011*

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## Written submission from Newark and Sherwood Homes Ltd

### Summary


- Concentration of Affordable Rent and Low Cost Homeownership to deliver supply.
- Concentrating resources in Growth Point Areas.
- Targeting areas and local authorities which offer efficiencies.
- State Lending at low levels of interest rates.
- Flexibility on Agreements and arrangements with the Self-Financing Borrowing Cap.
- Local authorities needing to retain asset and maximise number of properties for Self-Financing Business Plans.
- Guarantor being high risk unless there is a large gain.
- Pension Fund and Investors being more attractive to Social Rented Sectors.
- ALMOs realigned to allow private borrowings not to be public as the current inequality.
- Self-Financing developing significantly more properties while adding to the local authority asset.
- Affordable Rent crating sustainable supply for the future.
- Affordable Rent however expensive in some areas and still demand for other tenures.


*How and where the more limited capital and revenue public subsidy can be best applied to provide the biggest return on the investment, in housing supply terms*

The Affordable Rent Programme is anticipated to be a success in achieving this goal due to the lower subsidy requirements per unit created compared with social rent. It must however be stated that there will still be demand for social rent properties but it is appreciated that there is a strong middle market with demand for affordable rent and low cost home ownership initiatives such as Shared Ownership. This will allow properties to be generated with a low grant input in terms of capital and no requirement for revenue funding. Projects could be targeted which are at areas with Growth Point Status where there is already a key intention and desire to construct further properties and input may well act as a catalyst to assist development from commencing for all tenures.

Affordable Rent and Low Cost Home Ownership products do however need to be targeted where there are strong areas of demand and that they are financially stable but would generate the greatest return in housing

supply. It should however also be noted that there are areas of the country which have less viable lower rental levels.

Capital can be invested where there are efficiencies such as with Local Authorities for New Build Proposals. Where they are already a landowner for example in Newark and Sherwood for the Local Authority New Build Scheme, 52 new properties have been constructed with an average grant per dwelling of £41,750 which is vastly below the average grant per unit for Local Authority New Build at £91,831 per unit or £59,148 per unit for the National Affordable Housing Programme 2008–11. There are therefore providers who work efficiently that can be targeted.

Where local authorities are not however in the receipt of land there is potential to acquire properties particularly in Growth Point Status areas by Section 106 Agreement adding additional Affordable Housing with no or limited public subsidy.

Build or acquisition by a local authority would lead to asset retention helping the 30 year Housing Revenue Account Business Plan to support the debt by retaining assets for the long term. It is considered that disposal of assets could undermine the long term business plan and therefore viability going forward under the Self-Financing Agenda commencing in April 2012.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

There can be a requirement for state lending or investment on an ongoing basis as opposed to grant funding of schemes, although it is perceived that many schemes will not be viable without grant input. In terms of lending certainty and the level of interest, rates would need to be appropriate and as low as possible to encourage these to be an attractive proposal for any provider. In terms of investment mechanisms these could be considered by some providers negatively but if there is flexibility on any agreement and terms which would be acceptable to providers' constitution and governance then these should be explored appropriately.

The question will be whether State Lending and investment can be sustained by the Self-Financing Business Plan for the HRA. Measures may be required which ensure that lending can occur but still be contained under the borrowing cap.

*What the role is of the public sector in providing support in kind-for example land or guarantees-opposed to cash, and what the barriers are to this happening*

There is a potential strength for public sector such as local authorities to provide land for the development of affordable housing but all local authorities at the current time would be keen to obtain ownership of assets for the long term future to assist with their Self-Financing Business Plans post April 2012. It is therefore considered that mechanisms should be available throughout local authorities to develop properties while retaining this asset to create the much needed affordable housing which is also likely to create efficient developments if carried out effectively. Land not suitable for affordable housing could also be considered for other uses in a partnership arrangement to ensure that suitable development occurs with a reciprocal arrangement allowing for the creation of affordable housing on more suitable sites which could be in private ownership. Historically land deals and arrangements are often in place with the intention to deliver increased quantities of Affordable Housing. With Self-Financing however the value of assets or receipts generated is more important to local authorities for paying off debt and ensuring they have a sustainable model for the future. There is a greater risk associated with disposal of any asset because of the focus on income generating or the potential to development income generating assets in the Self-financing Structure.

It is considered for the public sector to be acting as a guarantor for a private sector or Registered Provider to construct as this would potentially increase the level of risk above an acceptable level. The only time which some kind of guarantee would be viable would be if there is a higher return in terms of numbers of increased units were to be developed for Affordable Housing which could be transferred to the local authority to increase its level of stock in return for parting with the land to a developer whether they are a Registered Provider or Private Sector. A significant increase in property numbers that was higher than if the site was developed by the local authority itself would generate an improved position which may encourage the disposal of the land asset.

Right to Buy Discounts being increased are adding to concerns with regards to Asset Ownership and Self-Financing. Equity Deals with a payback on return of investment however could be attractive and link to Government Proposals.

*How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

It is felt that there is currently interest from larger financial institutions particularly Pension Funds to become involved in Private and Social Rented Sectors. The Social Rented Sector has a more stable long term return potential being less volatile than the majority of market driven investments. An example of this has already occurred with AVIVA investing in properties for affordable/social rent with the registered provider—Derwent

Living. As this deal becomes more public it is likely that other financial institutions will follow suit to provide long term finance of a non-traditional nature.

The main barriers at the current time are thought to be of scale and location. Many long term large investors more interested in large scale developments in the South of the country creating a divide in the availability of finance. The same considerations can also be provided for the Private Rented Sector where large portfolios around areas with high market rental values would be more attractive to a financial institution.

*How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

There are currently concerns with the Housing Association sector particularly those involved with swops in terms of the future availability of finance or the new cost of finance for the long term. Publication of the reserves held by some large Registered Providers could encourage them to invest in new housing supply with little or no public finance involved.

For the ALMO Sector it is currently considered that there is a great disparity between them and a Housing Association in the way finance is treated. At the current time if a housing association raises a charge based on its income stream from rented properties this is counted as private subsidy. However in the terms of an ALMO borrowings paid for by rental income on the stock, are currently being considered and referred to as public subsidy in the way that developments are assessed by the Homes and Communities Agency. The finance can be privately borrowed and repaid in the same mechanisms but for the ALMO Sector it is categorised as public borrowing despite being the same low risk. An ALMO is an anomaly having private accounts for a Publicly Owned Company.

The realignment of this inequality would increase the ALMO Sector to develop further and be assessed along with Housing Associations especially as they will be accessing Local Authority land and therefore allowing development to be constructed in an efficient manner whilst retaining the asset from the asset base to maximise the Self-Financing Housing Revenue Account.

A mechanism to enable an ALMO to develop within the headroom or that unlocks potential borrowing outside of the debt would encourage further investment. This could currently be carried out only as part of a company with co-ownership and the local authority being a minority shareholder or by the creation of a charitable subsidiary. It is a proven delivery vehicle with Decent Homes success.

Newark and Sherwood Homes has carried out extensive modelling and sensitivity analysis around different scenarios and would be willing to share these to assist for consideration on request.

*How the reform of the Council Housing Revenue Account system might enable more funding to be made available for housing supply*

As the Self-Financing of Housing Revenue Account will enable more funding to be made available for housing supply as generated head room will allow local authorities to further develop new supply. Further supply will ultimately increase the value of the local authority assets and also income for the organisation while also offsetting any properties which are lost through Right to Buy sales with concerns on increased discounts. This will therefore create a more stable portfolio with the creation of further efficiencies through economy of scale. It does however mean that local authorities will need to retain and maximise assets as a result of the reforms. Audit needs to be in place internally to ensure correct handling of this higher risk activity.

In terms of examples Newark and Sherwood Homes have calculated that if no debt is paid off by Newark and Sherwood District Council over a 30 year Business Plan the reform could fund 1,720 new dwellings, if they decided to pay off a figure of £10 million during the life of the 30 year plan then the build would still facilitate 1,630 new properties to be created. There are therefore other scenarios which would be available allowing build in different years to maximise balance and repayment during the 30 year plan. This would therefore if replicated through the country create a significant supply of additional dwellings which are in great demand.

It is felt that proven Delivery Mechanisms such as ALMOs should be used with a track record of results from Decent Homes delivery. This would reduce the difficulties faced by the HCA when cash take up by Housing Associations is below forecast.

*How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term*

It is felt that the new Affordable Rent Proposals are likely to be sustainable over a longer period of time due to the low grant input required to create the properties. However affordable rent is more attractive in higher value locations or ones with greater demand but the product itself could be less sustainable in extremely high value areas such as London where the affordable rents are not affordable. It is felt that the product will increase the Housing Benefit pressure although there is a demand for this more intermediate style product particularly in the unsettled financial environment.

There is still further demand for Supported Housing Initiatives and that other products are also required to support the affordable rent initiative in particular with the current aging population. Care must be taken with conversions into Affordable Rent from Social Rent to enable sufficient income to be generated to allow increased levels of development yet to not diminish the social rent properties which are also in demand to an unsustainable level.

*October 2011*

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## Written submission from Moat

### About Moat

1. Moat is a housing association providing affordable homes in thriving communities for people in the South East of England. For over 40 years, we have delivered high quality general needs homes for affordable rent, supported accommodation and tenancy support services. Employing approximately 400 people, we provide excellent customer service to the residents of our 20,000 affordable rented and shared ownership homes.

2. Moat is one of the Homes and Communities Agency's development partners and is also the appointed HomeBuy Agent in Essex, Kent and Sussex. We have provided homes for low cost home ownership since the early 1980s, and continue to help first time buyers with a range with a range of intermediate housing options.

### Submission

*Summary*

3. There are two specific tenures that we would like to offer our expertise on: affordable housing and shared ownership. We believe that both of these tenures are vital to the overall housing mix.

4. On affordable housing, it is our view that housing supply could be increased with further tenure reform. Our reform proposal (outlined below) would be aimed at ensuring a more efficient and targeted use of public subsidy whilst allowing people the security to remain in their homes.

5. On shared ownership, there is work to be done on capital adequacy regulations. This is an area that is feeding reluctance among lenders to both: lend for shared ownership products and; engage in the implementation of new products. The consequence of this is increased reliance on public funding for further development.

6. Therefore, it is our view that ensuring a combination of tenure reform and correct financing arrangements for both affordable housing and shared ownership will be vital to securing adequate supply.

*Affordable housing*

7. It is Moat's view that there are two main methods of increasing the supply of subsidised affordable homes. The first method is to develop new homes, at a cost to the taxpayer through capital grant. The second method is by "shifting" more residents from subsidised homes into non-subsidised tenures.

8. In order to achieve the latter—with a view to increasing the supply of affordable housing with minimal-to-no extra public subsidy—there is a need for further tenure reform. We deliberately use the term "shifting" rather than moving, as we believe this can be achieved without the need to evict tenants. In other words, we aim shift the tenure without moving the resident.

9. In order to make better use of resources, as well as to potentially increase supply of affordable homes, we propose an alternative model, designed as an enhancement of the Affordable Rent model—not a large-scale reconstruction.

10. In short, as an alternative to terminating tenants' tenancies as their circumstances improve, we suggest an amend to the Affordable Rent model that would allow registered providers to charge full market rent where circumstances warrant it. It would consist of the following:

(a) a *review of rent affordability* against the income of residents every set number of years (for example, every two or five years);

(b) where residents are able to pay full market rent for two reviews in succession, their rents would be increased to *full market levels*; and

(c) when a resident is placed into the full market rental category, we would offer the *opportunity to move to shared ownership*—with the normal rent discounts that apply within this model;

11. Most importantly in the context of increasing housing supply, we propose to ringfence the additional revenue raised through this model and *reinvest it back into the development of more homes.*

12. Our aim through the use of this model would simply be to increase the supply of affordable homes, without placing extra strain on the public purse. This can best be achieved by shifting more residents from subsidised homes into non-subsidised tenures.

*Shared ownership*

13. Set against a background of current statistics, it is of little surprise that shared ownership remains a well-regarded and popular product: the average age of a shared ownership buyer is 32 years, which compares to 37 years of age on the open market.[5] In 2007–08, the median income for households purchasing a shared ownership product was £25,832, compared with £33,680 for shared equity purchases and £38,900 for open market purchases.[6]

14. In 2008/9 44% of shared ownership buyers had incomes below £25,000. Almost a quarter had incomes below £20,000.[7]

15. As a result of the combination of stubbornly high house prices, poor mortgage availability and the rising cost of private rents, demand for shared ownership products remains very strong.

16. From a taxpayer perspective, shared ownership is also desirable. The subsidy requirement for shared ownership is equivalent to approximately a quarter of that for social tenancies.

17. Despite its many advantages, shared ownership has not become available on the scale necessary to ease the UK's housing crisis. In large part, this is due to lenders' high deposit requirements combined with the limited number of mortgage products available.

18. Current regulations on capital adequacy are compounding the reluctance of lenders to both: provide mortgage products for shared ownership, and; engage constructively in the implementation of new products that reduce reliance on public funding to bring affordable homes to the market.

19. It is our view that until the Financial Services Authority (FSA) reviews its capital adequacy requirements to more appropriately reflect the true risk[8] associated with shared ownership products, lending for these products are unlikely to increase—and therefore, nor will supply of this type of housing.

20. There is some concern that the best efforts to stimulate housing supply may be significantly undermined by an instrument of policy that could—and should—be altered. It is our view that the financial regulator's focus should be sufficiently broad as to consider the impact of policy on the economy as a whole.

21. Largely as a consequence of the regulator's stance described above (para 16), lenders are reluctant to engage with housing associations to develop new products, or indeed, to increase supply of existing products. It is of concern that this could be the case on a product that is of no greater risk to the banks, and of lower cost to the public purse.

22. Clear guidance is needed from the FSA for lenders to work constructively with housing providers on products that meet acceptable risk criteria for all parties. In the absence of such guidance, large amounts of public money will need to be pushed into low cost home ownership products in order to increase supply.

*October 2011*

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## Written submission from Midland Heart

Summary of Main Points

- We feel that there is little room for manoeuvre in order to better apply the capital and revenue public subsidy, although we consider there to be a case for relaxing controls on PRP current asset management strategies and that the ring fencing parts of supported housing funding should now be seriously reviewed.
- Midland Heart believes that given the current state of the economy, central government lending is not likely to offer further benefits or be viable through PWLB. However, we have posed the question as to whether funded government pension schemes might be encouraged to invest in social housing (recognising the concentration risk which this might pose for some such schemes).
- There are a number of roles for the public sector. They include the provision of land for social housing development but, related to this, there may be further scope with the relaxation of valuation rules and a review of specific covenants that pertain to land and capital grant funding.
- The potential impact of the Community Infrastructure Levy as now envisaged within the Localism Bill should be reviewed to better assess its impact on the supply of affordable housing through Section. 106 agreements.
- We believe that bringing long term private finance into the future provision of social housing can be effected through a number of approaches, including continued access to the capital markets or through club issues such as THFC. However, we should also consider constraints on gearing and whether the main banks can also develop more lending arrangements.

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[5] Promoting Shared Ownership Group: *Shared Ownership: Facts& Figures*, 2010.

[6] Blue Sky: *The Role of Shared Ownership in the Future Housing Market—A Discussion Paper,* 2010.

[7] Promoting Shared Ownership Group: *Shared Ownership: Facts& Figures*, 2010.

[8] Shared ownership defaults stand at 0.38% compared to 0.42% for conventional mortgages—equivalent to 10% less risk of default.

— There are serious issues of concern regarding the impact of Welfare reform which may have implications for further private finance. For example, direct payments to tenants are viewed with suspicion by lenders.

— Whilst reform of the HRA is welcomed we feel that there will still be limitations to further local authority borrowing, given prudential debt ceilings. To combat this, we believe that there should now be greater scope for partnerships arrangements between councils and housing associations to realise borrowing potential and deliver more affordable housing.

— Midland Heart believes that whilst generally there is potential for affordable rents to increase income levels for social housing providers, its effectiveness is likely to vary from region to region.

— There are concerns that affordable rents as currently planned, may be too closely linked to market fluctuations rather than to what individuals may be actually able to afford.

— Looking to the future, we feel that providers should be more focused on increasing efficiency—reducing costs whilst maximising income. In addition, there should be greater flexibility to enable associations to make the best possible use of their assets.

## Introduction

This submission to the Communities & Local Government Select Committee offers an important opportunity for private registered providers of social housing to give our views on issues relating to both the financial advantages and constraints to funding new housing.

Midland Heart accepts that the current system is overly complex and requires an overhaul with clearer guidelines. We recognise that whilst resources are finite, they should also be targeted to those in most need and that the Government facilitate in what ever ways possible more affordable housing.

Our submission is intended to respond to key questions raised by Select Committee and to feedback our concerns for the provision of more and better quality social housing to meet a growing demand for more affordable housing.

## About Midland Heart

Midland Heart is one of the largest social housing, care and regeneration groups in the country and the largest based in the Midlands. We operate across over 55 local authorities and have approximately 32,000 homes, including nearly 22,000 general needs rented properties, over 2,000 shared ownership homes and a very significant care and support provision of nearly 6,500 units of accommodation. Each year, we have invested over £100 million in improving homes, building new ones and making neighbourhoods more desirable and sought after places to live in.

At Midland Heart we firmly believe that every customer should be able to live in an environment that is affordable; where they feel safe, are empowered; can influence services, and where their care and support needs are appropriately met. The Midland Heart way is to help transform lives and communities through housing, care and more.

We use our resources to respond to local need, championing local causes whilst delivering the benefits of a larger organisation, ensuring a voice for customers both at a national and regional level. We operate across a large number of local authorities, working with our customers and their communities to understand the issues that concern them and seeking lasting solutions. Our work involves, supporting those who need help to live independently, assisting in regenerating communities and helping an individual to discover their own abilities just as much as it involves providing and maintaining homes for more than 70,000 individuals.

We believe that access to housing has now become a key issue for many communities. Traditionally, social Housing has accommodated and supported some of the most vulnerable and needy in society—including those on the lowest incomes—with higher health inequalities and the potential for high care needs, often unable to access any other form of housing.

## Detailed Submission

*How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

Midland Heart feels that there is very little scope for significant changes here as a consequence of extremely limited grant availability. Given the varying local property markets across the country, we believe that there is an argument for relaxing controls on housing association's current asset management strategies and allowing the flexibility so created to enable redirection of grant away from London and the South East towards more strained housing market areas.

In addition, we feel that current attempts to ring-fence elements of the programme to supported housing are to be welcomed, but that proposals to change housing benefit arrangements for supported housing could undo all of this good work by making any new development unviable.

We note also that both the biggest pressure on the Welfare Reform Bill and some of the poorest quality accommodation remains within the private rented sector, and we would welcome consideration of whether central and local government can explore options to redirect some of the public subsidy paid to poorer quality private landlords into the provision of affordable housing by registered providers.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

We believe that state lending through the PWLB is unlikely to be viable given the current economic crisis, and does not appear to offer many benefits compared to existing sources of private finance.

The state already has a quasi-investment role given the provision of grant and the RCGF arrangements and to introduce any further element of investment return (for example, making RCGF interest bearing) would inhibit the ability of housing associations to increase investment in new stock.

Central government may wish to consider whether funded government pension schemes such as LGPS should be encouraged to invest in social housing projects, while recognising that this must be the decision of the trustees of such a scheme and taken in the longer term interests of scheme members.

Finally, in respect of shared ownership property we feel that the government's influence over state-owned banks should be more fully exploited to place pressure on lender's underwriters to recognising the mortgagee protection clauses. In our view, this would prevent lenders from increasing interest rates on shared ownership lending. This action might also influence a reduction in deposit levels based on a perception of reduced risk and, ultimately, might encourage more shared ownership mortgage products to be made available and offered to prospective purchasers.

*What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening*

Support in kind can take a number of forms. Provision of land is the obvious example and we feel that this should continue to be encouraged.

In addition, further relaxation of the rules relating to the valuation of land transferred to housing associations should be considered so that local authorities are not placed in the position of requiring a land receipt which then directly takes away from the provision of social housing.

Consideration should also be given to the extent to which land and capital grant funding is provided with conditions which affect the value of the land. Covenants which require land to be kept in perpetuity for social housing or, worse, for a particular client group, significantly limit the value of property as security and limit housing association's ability to borrow against the property. Allowing such rights to fall away once a mortgagee exercises its right to possession of the property would substantially deal with this issue.

Finally, we also feel that there should be further consideration of the potential impact that the Community Infrastructure Levy (CIL) as now outlined within the Localism Bill could have on the delivery of affordable homes. To date, a large proportion of social housing has been achieved through Section 106 agreements, but if CIL were to be set at a level that is too high, then s106 affordable housing proposals will become extremely challenging to secure and could lead to a potentially substantial reduction in new affordable housing. In respect to this issue, we would refer Select Committee to the recent briefing by the National Housing Federation on Part: 5 of the Localism Bill (Lords Committee stage), whose detailed concerns we would echo and whose recommendations for amendments we would strongly support.

*How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

For larger housing associations such as Midland Heart, the capital markets remain the obvious solution and there is an effective liquid market for housing association debt, albeit one which is less favourable for PRPs than it has been.

For smaller associations, the issue costs mean this is unlikely to be cost effective and so the continuing use of club deals such as THFC should be encouraged and expanded where possible—although heavily structured and security intensive deals should be avoided because of the way in which they tie up security and limit future borrowing.

Gearing is increasingly becoming the constraint on future borrowing for the sector. Consideration of ways to mitigate this should now be seriously considered. For example, thought should be given to whether the recent Places for People retail and unsecured bonds provide an alternative to secured facilities.

In addition, the government should also consider whether it can use its influence over majority state-owned banks to develop appropriate lending solutions for the sector.

Pension funds and other institutional investors clearly have a role to play in the provision of private finance to the sector and this should be encouraged. The downside for housing associations in these deals is typically

the level of occupancy and income collection risk that they are asked to bear. We believe that consideration of how this can be mitigated could prove fruitful.

We feel that the government should also bear in mind that housing association activity has continued to be buoyant—due in part to the sector's strong credit rating—and should think carefully before taking action which might impact on this. Rating agencies are particularly concerned about the prospect of universal credit being paid directly to tenants and learning from the pilots about the point at which benefit should be paid directly to landlords will be critical in reassuring them.

*How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

See above comments.

*How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply*

Reform of the HRA has the potential to enable more borrowing to support new supply, subject to prudential borrowing limits for local authorities. However, it is likely though that councils may find themselves with increasing revenue streams which could be used to support borrowing but with a prudential debt limit which does not permit further borrowing. In this instance, we believe that consideration should be given to whether public/private partnerships between local authorities and housing associations where a JV borrows on the strength of these receipts can deliver more funding for affordable housing.

*How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing*

It is our view that the affordable rent proposals could generate more income and thus support more borrowing and hence new supply, but, that the impact will vary markedly across the different regions. In addition, we are concerned that rather than being linked to what people can actually afford, it is being linked to the market. As we have already recently seen large rental increases because of the deteriorating housing market through a shortage of mortgage availability—which has notably impacted on first time buyers—the whole issue of affordability now becomes challenging.

The main factor which might permit housing associations to deliver more housing will ultimately be anything which enables them to drive down the cost per unit and free up more surplus to service future borrowing. We therefore feel that the focus on increasing efficiency among associations should be welcomed, as should the refocusing of regulatory activity.

In addition, consideration should also be given to the extent to which the government can and should encourage mergers between associations to deliver economies of scale and in particular encourage the use of the balance sheet strength of those associations which have not previously developed. Finally, Midland Heart feel that a flexible approach to asset management which unburdens associations to make best use of their assets should be welcomed.

*October 2011*

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**Written submission from The Housing Forum**

This short paper focuses on The Housing Forum's 2011 industry assessment of the implications for delivery of new affordable rented homes.

170,000 new homes are proposed in the Government's Affordable Homes Programme 2011–15 and in the context of rising shortage of homes, the crucial challenge for housing providers and contractors is to make sure these homes are built and potential blockages acknowledged and dealt with. This requires all involved to create the environment for delivery.

The Housing Forum's view is that we have reached a tipping point of change in housing, where new homes are urgently needed and the process of finance, delivery, planning and regulation need both simplification and a longer term planning horizon.

The assembly of funds for the new affordable rent programme relies on the charging of "near market" rents by housing providers and access to loan finance. The implications of this change fundamentally affect the business model of developing housing associations with implications for the wider housing sector.

This paper summarises the key issues we consider could affect full delivery and is drawn from a survey of Housing Forum members on the new framework and from recent meetings of The Housing Forum Working Group, with contributions from developing housing associations and affordable homes contractors.

### Funding: Confidence or Risk?

There is an increased cost of borrowing to build despite the lowest interest rates for many years. As a sector, housing associations are in a relatively strong position if banks are prepared to lend. The perception of the financial markets about housing investment is positive. Private finance has supported the sector since the reforms of 1988 without default and with a good track record. The overall financial picture however is now less stable and all housing organisations are potentially more exposed to risk.

Maintaining the confidence of potential lenders is crucial and concerns about the proposed universal credit on housing associations' rental streams will need to be met. Where development finance depends on income from shared ownership and outright sales, mortgage funding to support this must be readily accessible.

New financial models, including a move away from the banking sector into the long-term capital and equity markets, is a prospect, but there is relatively little experience of accessing this market across the housing sector.

New innovative use of funding is critical to the challenge of meeting the affordable housing need in the UK. We are encouraged that funding from institutional investors (eg pension funds) is starting to become a clearer prospect. These models may work on a longer time span than current financial models (typically 30–50 years) and need to be explored and encouraged. This will be a significant catalyst to re-shape the housing association sector.

### A Radical Reshaping of Housing Associations?

Housing associations have wider issues beyond their affordable homes building, which concern their long term viability as businesses. The impact of much-reduced grant allocations has been significant in triggering a review of value and priorities within associations. In some cases, housing associations have been preparing to build without grant, predicting this as a possibility, but the impacts of changes now are much more far reaching. This is leading to a review of the wider business beyond the HCA supported development programme. Both board and senior management teams will need to be robust to take their organisations in new directions, manage financial risk, and develop commercially viable solutions while retaining their social values and objectives.

For the near future the debate with government on the shaping and funding of future affordable homes programmes needs to happen now. We welcome the DCLG Select Committee's work in kick-starting the debate.

In the future, value for money will be even more critical, especially for the "top 50" developer organisations, which will shoulder the major burden of the programme. We see this leading to clearer and more transparent recording of value for money within organisations and to robust options appraisals on future investment choices. Efficiency, and effective and relevant regulation, will become levers for change that need to be coherently woven into the fabric of the new operating environment.

Meeting greater financial obligations requires a balance between commercial outlook and the traditional social business. This forces housing associations to look differently at priorities in the long term and to look again at priorities in day-to-day management.

### Planning and Land Policy

Delivery can only be achieved with council support and by local councils taking account of affordable homes provision in local planning policy. Transitional arrangements, possibly moving away from s.106 delivery of affordable homes need to be planned now. Equally, we believe the HCA policy to move away from funding sites delivered through s.106 mechanisms should work through a transitional phase rather than a blanket policy application, as this could result in programme delivery risks.

s.106 policies have to catch up with the realities of current house building. Viability has to be an issue in future affordable housing strategies in an era of reduced grant, and it is likely that lower percentage affordable homes outputs will have to be negotiated. Without grant, s.106 levels of housing provision will fall—with economic consequences for house building and growth.

The New Homes Bonus, as part of a wider initiative to encourage house building and economic growth, has yet to be demonstrated, but we recognise that there are signs of increased rewards for local authorities this year. We believe that it is more likely to achieve an increase in numbers of homes built when combined with other stimuli, particularly access to public sector land releases.

Land remains the critical balancing factor in cost and viability. HCA land assets have been increased by the transfer of RDA assets and these create a potential opportunity to access land at deferred of nil cost to support the affordable programme.

A coherent approach to the use of public sector land needs to be addressed—this could help to re-energise a successful rented market.

### Working with your Local Council

Increasingly, the London market and the rest of the country are seen as likely to have separate issues and outcomes due to different market conditions and local political frameworks. In London particularly, home ownership levels are predicted to fall and the private rented sector predicted to expand.

Councils' co-operation towards the rent changes under the affordable rent programme (80% market rent) may present some difficulties. As delivery depends on achieving rental income, a quick turn-around in council nominations for vacant tenancies needs a prompt "cascade" of lettings. Bureaucracy at the point of application for re-housing can lead to delays that have a commercial impact on the business plan and work against customer choice.

The opportunity for affordable rent to provide real flexibility in who is housed can be protected by sensible and balanced local lettings policies. Balanced communities, helping economic growth, and affordable renting for the lower waged are all groups in need of housing that could be helped in this programme, with flexibility in lettings arrangements. Flexibility should apply to schemes both within the affordable rent programme and those negotiated separately. This is given greater emphasis by the conclusions of the Oxford Economic report for the National Housing Federation (home ownership will slump to 63.8% over the next decade.)

### Our Housing Economy

Home building benefits the whole economy. Not only does house building create job opportunities locally, it is also a massive stimulus in the supply chain, in materials and white goods. 92p of every £1 spent in construction stays in the UK and the same £1 invested in construction generates £2.84 in economic activity (Source: Construction in the Economy October 2010, UK Construction Group).

The housing construction sector can be a substantial source of opportunity for apprenticeships and skills training. This stimulus is likely to have direct local benefit on income levels and on local suppliers and small businesses.

### The Next Steps for The Housing Forum will be to

— Press for a coherent approach to housing the nation, aligning financial, land and regulatory issues to achieve and go beyond 170,000 homes.

— Continue to review whether the new programme is working as expected and consider the organisational impacts of it across the whole housing industry.

— Follow the delivery of new developments, assessing if the numbers anticipated will be delivered and what impact this will have on the overall demand for all affordable housing options.

— Whilst we understand the Government's priority to tackle the Country's structural deficit we believe a properly focussed investment allied to greater freedoms and flexibilities could help to generate a real stimulus for the UK economy.

*October 2011*

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## Written submission from Birmingham City Council

### Summary

Birmingham City Council has an unparalleled record in developing new homes for sale and rent;

The Council has developed an innovative model for derisking development and attracting private sector developers to build in challenging market conditions;

This is an approach which has been proven to be successful by the private sector.

*Response to how the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply*

(1) Remove the proposed borrowing caps for local authorities.

(2) Reclassify housing debt outside public borrowing.

(3) Allow the transfer of unutilised debt headroom across local authorities.

(4) Revised RTB Receipts Policy.

*Response to how long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

Tax Incentives.

100% capital allowances.

Incentivising development through lower interest rates.

Bond issues.

*Response to what the role is of the public sector in providing support in kind-for example land or guarantees-as opposed to cash, and what the barriers are to this happening*

We believe that LAs can use their land to incentivise development and our approach through the BMHT model demonstrates how this can be achieved.

*Response to how effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term*

We applaud the intention to capture the surpluses generated by RSLs and ensure that these are reinvested into new housing development. However we do not believe that the ARP model is replicable or sustainable and that the impact on housing benefits and those in receipt of benefits has not been thought through.

*Response to how and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

It is our contention that the limited capital and revenue public subsidies available can be best applied through local authorities for the biggest return on investment.

*Response to what the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

The use of public subsidy should be made available to RPs on the criteria of value for money and means testing.

*Response to how housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

RSLs should use their reserves for development. Tax incentives or preferential interest rates should be used to encourage investment in the development of affordable housing.

*Birmingham, City Council's track record in delivering new rented homes*

BCC has an unparalleled track record in maximising the delivery of affordable rented homes in partnership with the HCA.

In January 2009, we launched the BMHT, our brand name for new Council homes developed out side the HRA subsidy system, and in that time we have completed the construction of 200 new rented homes. All of our homes have been developed on time and on budget and to high standards of design and sustainability. We have a development programme of 1,340 new homes over the next few years which comprise a mixture of homes of both rent and sale.

Our model for the development of new homes for open market sale was launched in 2009 and has proved to be highly successful, despite the unfavourable conditions in the housing market.

| *Programme* | *HCA funding (total)* | *Approx grant per unit* | *No. of Units* |
|---|---|---|---|
| Local Authority New Build (LANB 1) | 6.7 million | 51,900 | 129 rented homes |
| Local Authority New Build (LANB 2) | 5.4 million | 53,400 | 101 rented homes |
| Public Land Initiative | 4.7 million | N/A—gap funding formula | 83 rented homes (151 homes for sale) |
| Local Land Initiative (Eastern Corridor projects) | 2.9 million | N/A—gap funding formula | 19 rented homes/42 homes for sale plus demolition of two high rise blocks |
| Affordable Rents Programme | Bid made for £6.7million—Conditional officer received. | 21,700 | 305 rented homes (323 homes for sale) |

The Philosophy

The City Council through the BMHT is committed to the development of new homes for open market sale for a number of reasons.

Experience from regeneration projects across the country over the last 30 years has demonstrated that mixed tenure communities are in social demographic terms more sustainable than mono tenure communities.

The development of market homes via the BMHT also provides the opportunity to set high standards for new market homes in the city, at a time when the Government and CABE are indicating concerns about the construction and design standards of new market housing.

In order to meet the housing needs of a growing city, it is essential that the Council encourages the development of new housing in a range of tenures, not just affordable housing.

In addition, worklessness is a major challenge facing the city and encouraging the development of market housing is clearly one way of safeguarding existing construction related jobs and encouraging construction training programmes.

The surpluses created through the sales model also act as cross subsidy for the homes for rent and thus reduce the need for public subsidy towards the cost of the new rented homes.

### The traditional model for market housing

Under the traditional model, the Council sells land to a developer to build homes for sale, and who could also be contracted to build homes for rent for the Council according to the Council's specification.

The developer takes the risk of designing all the properties and is responsible for obtaining planning permission. The developer would not normally pay for the land until it had obtained planning permission for the units for sale.

Once planning has been secured the developer has to pay for the land up front (probably through borrowing) and does not achieve any financial returns until houses are completed and start to be sold.

Procurement of a developer is therefore a lengthy and costly process in which all of the risks are taken by the developer—firstly a developer has to be procured by competition, and then the developer in turn has to obtain planning permission.

### The MHT model

The MHT model recognises the fact that in the current market developers are risk averse and seeks to reduce financial risk to private developers by redistributing risk between the Council and the developer.

This is achieved in a number of ways:

*Design risk*—the Council takes on the design risk by designing up new homes to the Council's adopted Residential Design Guidelines, The Code for Sustainable Homes (currently up to Level 4), Secured by Design and Building for Life Silver standard;

*Planning risk*—the Council takes on the planning risk by submitting the planning applications and brokering discussions with all other stakholders and statutory undertakers;

*Site conditions*—the Council takes on the site conditions risks by carrying out all necessary surveys of the sites and taking any remedial action, eg Japanese knotweed treatment, contamination, that are needed to prepare the sites for new homes;

*Deferred receipt*—the Council does not receive payment for the land up front—instead the Council enters into a legal agreement with the developer to defer the land receipt for up to three years with an associated profit sharing arrangement of the overall development profit.

*Guaranteed work*—the contract is for the construction of both rent and sale properties and the rented homes contract offers the developer an attractive risk free construction contract to offset the risk associated with building new homes for sale.

The Council bears the costs of design for the market houses for sale "up front" and at risk—however the developer is expected to reimburse the Council on contract exchange for the apportionment of planning costs for the market houses which is *not* deferred on the same basis as the land receipt or profit premium.

The BMHT enters into a contract for a developer to both build the BMHT properties for rent and to build and sell the market sale properties. The developer's offer is based on how much the cost will be to the Council for the construction of the rented homes and an agreed minimum plot value for the deferred sales. The developer's offer for the sale site also includes what element of profit share the developer is prepared to offer, and the longstop date by which the developer agrees to build out all of the housing for sale.

The Council enters into a profit sharing arrangement with the developer through which instead of receiving the land plot premium at point of sale the Council receives a percentage of the overall development profit. This would provide an additional incentive for the developer.

The developer has the option to modify some elements of the specification for the market homes to make them more saleable—for example higher quality kitchens and bathrooms, en suites, higher specification fixtures and fittings;

The success of the model

This model was launched in 2009, following formal consultation with developers and has proven to be an unqualified success. The balance of risk and reward between the private and public sectors has been crucial to ensuring the success of this approach which is now being replicated across the BMHT development programme. Of the 1,340 homes in the programme, half will be developed for sale using this model.

BMHT currently has contracts with the following developers to deliver new homes through this approach—Keepmoat, Kier, Galliford Try.

In March 2010, the former Minister for Housing, John Healey MP, and the Chairman of the Local Government Association (LGA), Baroness Margaret Eaton, jointly established a Commission to consider how local authorities could ensure a sufficient supply of new homes for their areas. The current Minister of State for Housing and Planning, Grant Shapps MP, asked the Commission to continue its work and an Interim Report was delivered to the Communities and Local Government (DCLG) and LGA on 22 July.

As part of the research for the report, Lord Best visited Birmingham in 2010 and was favourably impressed by the work of the BMHT. This positive impression was reflected in the report *Housing shortages: what Councils can do—Final report*—which was published in November 2010.

Overall, this publication paints a very favourable picture of the work that Local Authorities are doing to provide new Council homes.

Key comments made by the report include:

> *"The Commission has been impressed by entrepreneurial skills we have seen displayed by today's Councils. Invariably local arrangements bring together the different players, often comprising major developers and house builders, housing associations and a variety of public, private and civic organisations"* (page 33).
>
> *"We have seen numerous examples of local authorities making creative use of the new LANB grants. They have demonstrated that small sums of public funding can go a long way through new Council housebuilding"* (page 38).
>
> *"local authorities have done better than housing associations in achieving Level 4 of the Code for Sustainable Homes and some have moved on to Level 5 and even Level 6 of the Code"* (page 39).

The work of the BMHT is well showcased on pages 36 and 41.

The comparison between grant rates for RSLs and Council new build on page 46 is also instructive. This shows that the grant rates for RSLs in the West Midlands in 2009–10 averaged £56,500 per unit, compared with a grant rate of only £52,635 per unit for Council new build.

The report also points out that:

> *"These lower levels of grant for the Council schemes are particularly impressive when it is noted that these contain higher numbers of three bedroom (and larger) homes and a higher proportion are built to Level 4, or above, of the Code for Sustainable Homes"* (page 46).

Working with Registered Providers

While the Council can justly claim a track record of excellence in delivering new Council homes, support to Registered Providers is also essential to meet the growing housing needs of a city of one million people.

In partnership with the HCA and through the City Housing Partnership the Council ensures that opportunities are available to Registered Providers to develop new housing. Despite the challenging economic conditions, the number of new affordable homes developed in Birmingham has risen over the last few years, to a peak of 981 in 2010–11.

While the Council is prepared to make land available at discounts or even at no cost in some cases, the general principle remains that RPs need to use their own resources to support development.

## Responses to Specific Questions

*How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply*

The HRA Reforms have the potential to generate funding to increase the supply of housing supply provided by local authorities. There are some risks that need to be considered, in particular as the reforms are based on a RPI plus rent policy and the implications from the new Welfare Reforms.

There are a number of additional actions that could be implemented to further increase potential funding and these are set out below.

(1) Remove the proposed borrowing caps for local authorities

The Council recognises the need and importance of macro economic control with regard to public sector borrowing but contends that there are adequate other financial frameworks that could be utilised to control total debt by local authorities. This could be effected through the existing CIPFA Prudential Code as this establishes a number of key ratios with regard to debt levels and rent income.

A number of authorities including Birmingham will be at the maximum cap at the start of the reforms and will therefore not be able to generate more funding for new housing in the short term until such time that debt is repaid over the medium term.

It should also be noted that the total local authority debt post the reforms is estimated at £28 billion (an average of £17,000 per property). This contrasts with an average of £30,000 per property for registered providers of social housing.

The total debt outstanding by local authorities compares very favourably to the estimated value of the housing assets, even on the current valuation methodology—existing use value for social housing (EUV- SH). The average property in Birmingham is valued at £25,000 based on the EUV-SH and this is assumed to be only 34% of the market value. These ratios are likely to apply to most local authorities and represent a substantial under-gearing.

(2) Reclassify housing debt outside public borrowing

The reclassification of housing debt outside the public sector borrowing has been a matter of much debate over many years and contrasts with the approach adopted by other European countries.

The undertaking of debt to finance day to day expenditure is not a strong fiscal discipline but borrowing to finance and maintain assets is a prudent and sustainable long term policy. This is a strong argument for the reclassification of this debt and also see (1) above.

(3) Allow the transfer of unutilised debt headroom across local authorities

The HRA Reforms will establish maximum debt ceiling for each local authority. A number of authorities will have potential headroom but will be unable to utilise this due to a number of factors, for example, shortage of land for development or low demand. A mechanism to allow the transfer of any headroom across local authorities would be helpful but this would be complex to administer and require an ongoing national framework to be maintained.

(4) Revised RTB Receipts Policy

The national pooling of RTB receipts until 2014–15 under the current GSR will reduce resources available to local authorities for new investment. The current policy should be reviewed and local authorities should be allowed to retain all the receipts and this would be consistent with the Localisation Agenda and the Self Financing HRA Framework. This will promote long term asset management and the replacement of stock lost through RTB sales.

The current cost of a new build property in Birmingham is £100,000 and the retention of RTB receipts locally would generate net additional resources of £45,000 per property. This together with borrowing would be sufficient to replace the property sold.

Nationally, the receipts are lower than 20 years ago due to a combination of the economic circumstances and the reduced availability of properties for sale (as a consequence of transfers of stock and the most desirable properties having been purchased). In Birmingham annual RTB sales are currently less than 200 (over the past couple of years) but were at a peak of 3,500 in the early 1990s.

This presents an opportunity to reconfigure the current discount policy and perhaps realign this to a percentage of the market value of the property as opposed to a fixed cash regional discount. This will be more transparent and equitable and will resolve some regional differences, namely, the maximum discount in South East authorities is only worth 10% of the valuation but up to 50% in Northern authorities.

The differential policies with respect to registered social providers of housing with the right to require could also be reviewed to provide greater incentives for RSL tenants to purchase their property (in Birmingham the maximum discounts for an RSL tenant is £11,000 compared to £26,000 for a local authority tenant)

*How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

We are proposing a number of measures to incentivise the private sector to provide rented homes. These include—tax incentives; bonds;

Tax Incentives

Government needs to incentivise development financially. At the moment, development is seen as risky by lending institutions and developers alike. Government needs to create the conditions to mitigate that risk and make development of new housing more attractive to the market. There are a number of mechanisms that Government could use to achieve this but fundamentally this needs to happen in one of two ways—either by introducing taxation incentives to make development more financially viable in a fragile housing market, or by creating the conditions in which borrowing is more affordable for developers. A couple of options for achieving these objectives are set out below.

100% capital allowances

The Government should consider 100% capital allowances for companies developing new, energy-efficient, managed affordable housing. This would significantly reduce the initial capital cost of development by an estimated 25% (Town and Country Planning Association). This proposal would be tax neutral to the Government as the reduced tax take might be more than matched by increases in tax revenue from increased development activity, alongside an associated "multiplier" effect.

Incentivising development through lower interest rates

Government could make development by LAs more attractive by offering lower interest rates to LAs for development projects through the PWLB. The loss in interest would be compensated for by other tax revenues related to development. Government could also devise mechanisms to reduce the level of interest charged on housing development projects.

Bond issues

(1) *Government housing bonds*

Housing bonds would be debt securities issued by Government to raise money for affordable housing development. This is a funding approach often used in the USA.

The bonds can be issued by state or local government and is repaid with interest over a period of time.

In addition to repaying the bond principal, the state or locality must pay interest on the money it borrows. Housing bonds typically have a low interest rate. For investors, the interest paid by housing bonds is **exempt** from federal and sometimes state income tax because housing bonds are a type of municipal bond. This tax exemption helps to compensate for the bonds' low interest rate.

(2) *Private investor housing bonds*

An alternative approach would be for housing bonds to be offered to private investors by appropriately regulated financial institutions.

These might carry up to 100% tax relief; if subscribed to by, say, 50% tax payers, such bonds should reduce the initial capital cost of affordable energy-efficient housing by up to 50%. The lost tax should be set against the increased tax take from increased development activity. The bonds, once subscribed, would be used to finance development by accredited affordable housing providers, including suitably accredited local housing trusts and local authorities, in areas designated locally by councils.

(3) *Local authority bonds*

There are no legal constraints on local authorities raising bonds directly. Such instruments have, in the past, been used to fund public infrastructure—notable examples include Birmingham City's use of a bond to fund the National Exhibition Centre (NEC). But central government tightening of financial regulations on the use of public sector debt have made this much harder since the 1980s. An opportunity exists here for Government to ease these restrictions and make it easier for LAs to raise bonds themselves.

*What the role is of the public sector in providing support in kind-for example land or guarantees-as opposed to cash, and what the barriers are to this happening*

The key issue with LA land disposals is the legal requirement for LAs to achieve best consideration under section 123 of the Housing act 1985. While LAs have the ability to give discounts to RSLs in exchange for nomination rights, the principle of best consideration must govern all LA land transactions, and the starting point for LAs must be that they seek to derive market value from land sales. This is an approach which is being replicated by the HCA in its Asset Disposal Strategy.

However as described above, LAs can use their land to incentivise development by the way in which they dispose of land. Not insisting upon land receipts up front but only at the point of sale of the constructed property under the BMHT model makes a huge difference to developers as they do not have to raise the loan finance necessary to fund the purchase of the land. Deferred receipts schemes, coupled with incentive share or overage agreements can enable public sector landowners to meet the dual objectives of achieving best consideration and making sites more attractive to developers.

*How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term*

The affordable rent model will increase supply in the medium term however the issues with this model are:

- Most RPs have a limited number of rent conversions to support the programme and once these rents have been converted they will be unable to afford to develop any more new homes.
- The affordable rent programme by its very nature will result in increased rents. This will:
  - Reduce the number of social rented properties available;
  - Disincentivises people on benefits from taking up lower paid work and remain trapped in benefits;
  - Increase the cost of housing benefits across the board to the Treasury;
  - Create geographical concentrations of rich and poor as the advent of universal credit means that lower income families are no longer able to live in higher value areas.

It is not clear that the ARP will achieve its primary objective of capturing an element of the £1.6 billion in surpluses generated by RSLs every year, or the £20 billion + that is on RSLs' balance sheets. This is money that should be spent on building new homes rather than sitting on RSLs' balance sheets.

Government should review how successful the ARP has been in terms of ensuring that RSL: surpluses are spent on development, and come up with other ways to incentivise RSLs to use these surpluses on a "use it of lose it approach".

Government should also review the use of Recycled capital Grant funding (RCGF) to ensure that it is used on the development of new supply only, and made available for this purpose as soon as the receipts are realised.

*How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

It is our contention that the limited capital and revenue public subsidies available can be best applied through local authorities for the biggest return on investment. This is on the basis that local authorities have a number of key advantages to secure value for money as follows (particularly the bigger urban authorities):

- tax advantages—in particular with regard to VAT exemption and corporation tax;
- the costs of managing housing are significantly lower than comparative RSL providers (due in part to economies of scale (for back office support) and the ability to defray overheads over a bigger general cost base of the Council;
- procurement advantages, particularly for larger authorities (Birmingham has secured significant savings for the current repairs and maintenance contracts (in excess of £37 million in the next three to five years);
- the availability of land that can be used for development; and
- the ability to borrow from the PWLB at reasonably preferential rates.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

The use of public subsidy should be made available to RPs on the following criteria:

Value for money—the cost to the public purse for each scheme measured in terms of the outputs it creates in terms of the number of new homes, affordability of rent levels, build quality, and jobs created;

Means testing—there is no justification for making grant available to RPs which have significant cash reserves—as suggested above, RPs with large cash reserves need to be incentivised to use these for development. Withholding grant from such RPs is one way of doing this. Historically the need for grant has been determined on a scheme specific basis, in future this should take into account the overall financial position of the RP.

The potential use of Government bonds has been described above—this is another way in which Government can make finance available for development.

*How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

A key suggestion for us is ensuring that RSLs use their reserves for development and that the willingness of RSLs to use their reserves is taken account of in the allocation of grant funding.

In terms of increasing the amount of private finance going into housing supply through RSLs and ALMOs, as described above potential mechanisms for this are tax incentives or preferential interest rates for investment in the development of affordable housing.

Role of housing development in the economy

In this context it is worth noting the benefits created to the UK economy by housing development.

The recent fall in housing activity has contributed to a 1% fall in GVA. Oxford Economics estimate that impact of the fall in house prices on consumer spending has contributed a further 1% fall. Put another way, the impact of changes in the housing market contributed to around a **third** of total fall in UK GDP from 2007 to 2009.

Housing therefore matters in macro-economic terms, especially as the overall national multiplier is one of the highest of any sector (due to the relatively low import content of housing output).

Research carried out in the US by the National Association of Home Builders (2010) estimates that building 100 new social housing units for families leads to the creation of 80 jobs from the direct and indirect effects of construction and 42 jobs supported by the induced effects of the spending.

In addition to these "real-time" jobs and economic activity, building 100 social housing units also leads to the long-term creation of 30 new jobs that support the ongoing consumer activity of these homes' new residents. For both developments, the National Association of Home Builders estimates that new residents would generate earnings for local business owners and employees in excess of $2 million annually.

*October 2011*

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**Written submission from Northampton Borough Council**

Thank you for the opportunity to respond to the review of Financing of new housing supply. Whilst we appreciate the current economic climate and the need to reduce the Nation's debt, we are also concerned for how the Housing Market is going to recover and once again start the process of providing much needed homes for households on Council's waiting lists and those households who can not afford to become an owner occupier at the moment and are therefore relying on the private rented market.

This has obvious knock on effects for our proposed new duties to discharge homeless customers in the private rented sector, as rental prices will inevitably rise due to the demand from the would be newly created owner occupiers in any normal recovery cycle of an economic cycle.

Attached to this covering letter is our Memorandum on some of the issues you have asked to comment on, and we hope you find our comments useful.

I would be happy to discuss any of the points we have raised.

1. *What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them?*

Each of these can play a role in different circumstances. Lending or Investment, with the opportunity of recycling that investment has to be a serious consideration, especially the way the Housing Market is going. Some sort of deferred payment "Build now Pay later" seems to be a realistic proposal currently. There will still be a need for Grant to a certain extent, but if this continues to be linked to Affordable Rent, we are not sure how sustainable this maybe longer term.

2. *What the role is of public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening?*

Northampton Borough Council Housing Department already have a good working relationship with its Private Registered Providers (PRP). On several occasions now we have made good use of our PRP Framework to offer land at Nominal Value to enable the delivery of new affordable homes. The barriers to providing General fund land at nominal value in the future will depend on the economic circumstances It may be the case that deferred capital receipts are applied to schemes going forward to enable the development to take off initially.

3. *How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening?*

Northampton Borough Council Housing Strategy team are currently exploring ideas with several private sector organisations who have pension backed investment to invest in the residential market. Given the changes to the Affordable Homes programme for 2011–2015, the affordable rent model has placed constraints on how new development can be funded through Section 106 schemes. Current discussions are focussed on how private investment can be used to fund these developments, which in Northampton provide the majority of new affordable housing supply. The only concern or barriers at the moment are most investment models are linked to the Affordable Rent (80% market rent) tenure. This is a concern for Northampton as gradually over time we will see the social rented stock diminish through PRP partners re-let conversions and our own stock through the RTB.

A study we commissioned recently to look at the impact of affordable rent on Northampton, illustrated that for most of our customers on the housing register, affordable rent as a tenure is not affordable. With almost 70% of our housing register on some form of means tested benefit, this is a worry.

4. *How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply?*

Northampton Borough Council welcome the freedoms and flexibilities that emanate out of the HRA Reform. Still dependant on final confirmation of the debt settlement later this year, the current 30 year HRA Business Plan forecasts sufficient headroom after the first five years to be able to provide funding for additional new build dwellings, which is a real ambition of the Council. However recent announcements on the RTB and increased discounts could impact on the business plan in a negative manner, and therefore the headroom we think we might have might not be there should recent announcements go ahead.

5. *How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term?*

As stated previously, affordable rent as a tenure does not work for those on the housing register in Northampton, however we realise that this is a form of tenure that can be utilised by other customers and are therefore supporting it. In terms of whether it will yield sufficient funds to be able to fund future development is very much dependant on the numbers to be delivered over the next four years. Currently PRP rents in Northampton are approximately between 72–75% of Open Market Rent, therefore there is not a huge uplift to benefit from. Given we are predicting to only have 100 affordable homes delivered every year for the next three years, and on average 200–300 PRP lets a year, there is not sufficient numbers to raise the level of funding you would require to build the same level of units year on year, without additional subsidy from either the PRP's themselves, local authorities or government grant.

*October 2011*

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## Written submission from the Confederation of Co-operative Housing

1. The Confederation of Co-operative Housing

The CCH is the national representative body for co-operative and mutual housing, a sector the Tenant Services Authority has identified as flagship performers in relation to tenant satisfaction. With a membership of over 110 community controlled housing organisations, the CCH has promoted community control since 1994, and has worked in partnership with Government, the UK co-operative movement, and other bodies to develop practical methods to implement community controlled housing. The CCH was instrumental in setting up the Mutual Housing Group which draws together organisations from the co-operative, tenant management, community land trust, self help, self build and community gateway sectors to help create a unified approach to developing new community led housing schemes.

2. Financing New Housing Supply

In the current economic reality, traditional approaches to providing the homes that people need are no longer viable. Mortgage finance for first time buyers will remain difficult for the foreseeable future, and the removal of public finance for traditional social housing and the introduction of the new model for "affordable housing" means that we are far from "business as usual".

The CCH has been in dialogue with the Homes and Communities Agency regarding innovative approaches to financing new supply through community led housing schemes and the impending funding for empty homes, self build and community led developments are a welcome move that linked with private and institutional investment have the potential to kick start the supply of new community led homes.

It is vital to build new partnerships for the new environment. Our "Building Co-operative & Mutual Homes" scheme is a new option for financing housing development. This proposal is built on the work of the Commission on Co-operative and Mutual Housing[9] which identified people who would formally have been first time buyers, elderly people looking for alternative options and others as potential markets for co-operative and mutual housing. It aims to generate the development of a large number of new co-operative and mutual housing schemes to enable more people in need of a decent affordable home to secure the additional personal and social benefits created by co-operative and mutual housing through innovative financial approaches as detailed in the report "Financing Co-operative and Mutual Housing".[10]

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9 The Commission on Co-operative & Mutual Housing was an independent Commission chaired by Adrian Coles, the Director General of the Building Societies Association. Its final report "Bringing Democracy Home" was published in November 2009.

10 Financing Co-operative and Mutual Housing—Blase Lambert—Confederation of Co-operative Housing, National Housing Federation and Chartered Institute of Housing—November 2010.

We held wide ranging discussions with banks and other financial institutions that aimed, among other things, to identify why lenders are reluctant to lend in small quantities to community led start-up organisations; the key reasons are:

- the loans involved are too small for specialist commercial lending teams and too big for the high street branches of banks;
- lenders do not like lending to new organisations lacking in business and management track records;
- lenders have little appetite for non-recourse loans; unless of a high credit quality;
- sourcing and managing a large portfolio of small loans is resource intensive;
- lenders do not want to have the resource requirement of dealing with default, which is proportionately higher for smaller loans; and
- a preference to lending to regulated entities.

In general the financing terms will follow the risk profile of the underlying project rather than the strict structure of the borrower. In the current market there is minimal appetite for speculative residential development among the major lenders, outside the major house builders or very selective schemes.

The conclusions of the Commission's work pointed towards batching or warehousing schemes in order to create sufficient scale to address the barriers identified, through a Real Estate Investment Trust, through loan or bond financing to a consortia of housing associations/private developers or by creating a savings and loans model (a housing development bank).

A proposal and expression of interest were sent to all local authorities in late 2010 in order to explore:

- the level of interest, particularly in local Government, in the programme;
- views on what will be needed to make the programme a reality; and
- what local authorities and housing associations can bring to the table to help develop the programme and realise the Commission's recommendation to expand the offer of co-operative and mutual housing as an option for communities throughout the country.

The key elements of the proposed programme are as follows:

- establishment of a fund through bond financing and institutional investment—anticipated to be about £250 million—to enable development of co-operative and mutual housing;
- the development of between 1,500 and 2,500 homes through the development of between 30 and 50 new co-operative and mutual housing organisations;
- the fund will be supported by a consortium of housing associations and other organisations with assets available to secure capital at competitive rates to new organisations (asset ownership arrangements will be dependent on the structures needed to secure capital financing); and
- to maximise possible cross subsidy (through making best use of available land, public grant, New Homes Bonus and other resources) to enable the greatest possible number of homes to be built—whilst making the homes as affordable as they can be.

The proposal is consistent with the Coalition Government's aspirations. It is about generating local community vision, responsibility and stewardship of assets that they have commissioned, designed and developed.

To date we have received responses from around 30 local authorities and 10 housing associations that have identified resources which could link into the programme and we are currently in the process of drawing these potential partners together to establish the necessary governance and financial arrangements to create the warehousing vehicle the will enable the programme.

### 3. Conclusion

Co-operative and mutual housing has the potential to meet the needs and aspirations of many groups of people—particularly intermediate markets. It has the ability to provide a safety net in uncertain times, whilst at the same providing people with options for control over their homes and neighbourhoods. We have found that some local authorities are seeing co-operative and mutual housing options as being necessary for their housing strategies, and are prepared to provide some resources to help develop local projects. Our programme is developing a realistic and practical way to raise the funding necessary in partnership with housing associations to build co-operative and mutual homes with very limited public funding. We are seeking to work with Government to implement the programme.

*October 2011*

**Written submission from the National Association of Estate Agents and the Association of Residential Letting Agents**

— Mortgage Finance Supply.
— Government Guarantee.
— Affordable Housing including shared ownership.
— Private Rented Sector.
— Stamp Duty Land Tax.

We would not wish to comment on other areas as we have no relevant information to provide.

**Mortgage Supply** in itself is not the problem which many commentators claim it to be. The key challenge is the level of deposit required by, in particular a first time buyer, with many mortgage products having an 85% Loan to Value ratio. The regional variations in house prices cause this to be a bigger problem in some parts of the country than others. Recent industry reports suggest that the average price of a house in London is double that of the rest of the country, and whilst incomes in the capital are greater there is insufficient salary differential to allow deposits to be accrued.

The same is true for investor landlords with most buy-to-let mortgage products being at 70%–75% Loan to Value ratio. ARLA's recent surveys indicate that there are investor landlords willing to purchase further properties: http://www.arla.co.uk/buy-to-let/buy-to-let-review/2011/q3/

However anecdotal evidence suggests investor landlords are being frustrated by:

— A lack of suitable stock available to purchase probably caused by potential vendors waiting on house price recovery as well as lack of new development due to lack of finance for developers.
— Rental arrears rising in the Private Rented Sector as illustrated by the recent ARLA survey and surveys by the National Landlords Association.
— Surveys by ARLA and BDRC independently indicate low gross rental yields, approximately 5 % return on investment. Even this return is quickly swallowed up by interest payments and maintaining properties in good condition.
— In the past landlords have been happy to sacrifice rental yield for capital growth but this is very uncertain in the foreseeable future.

**Government Guarantees** can take several forms including:

— Complex financial instruments. Such instruments underpin mortgage lenders by allowing them to lend to higher risk profile borrowers at a more competitive rate.
— Encouragement of Mortgage Guarantee products. In the past the insurance industry took an active role in providing insurance for lending above the normal criteria Anecdotally there appears to be little appetite within the insurance industry or the Government to resurrect this form of guarantee.

We suggest:

— Providing sufficient fiscal stimulation through tax breaks or other such tools to the insurers to make the market viable. One such option could be to allow a full write off for tax purposes and then a subsequent write back when repayment is made or when the guarantee has reached its maturity. A five year period may be appropriate. This would set a finite figure for fiscal subsidy by HM Treasury.
— Government to act as insurer/guarantor to the first time buyer market. This would allow a little money to go a long way. On a property valued at £180,000 with a 15% guarantee, allowing a 100% mortgage, this would equate to an underwrite of £27,000. £500 million of public money could underwrite approx 2,000 first time buyers. The advantages of this approach would be:
    (i) It would be unlikely that all of the guarantee would be taken up as a result of default.
    (ii) There would be income from the relevant premium charged.
    (iii) The capital repayment on the mortgage could be applied in the first instance to reducing the level of guarantee outstanding.

**Affordable Housing** has taken many guises over recent years including requirements for affordable housing for sale and rent within new housing developments, co-ownership, and shared equity.

Comments could be made about how all these have worked but some basic problems have existed with some. Owner occupiers who have not qualified for affordable homes may feel that they have in fact subsidised their neighbours as on re-sale those who bought affordable homes can end up in a better financial situation to move up the property market than those who bought full price. This is because both properties would be likely to achieve the same or very similar prices.

The shared ownership model has also been problematic. These schemes were originally seen as meeting the aspirations of people to become homeowners. Young single people who could not get housing by any other means were attracted to shared ownership schemes. However as their circumstances change they are becoming disillusioned because they are facing negative equity which was never a possibility brought to their attention prior to purchase. A typical example would be a 50% owned 50% rented situation, borrowed at 95% on the

50% purchase price of £100,000 in 2006. Owners who wish to trade up to owning the whole of the property are advised it is now only worth £90,000. To purchase the other half they have to finance the negative equity plus the deposit on the balance of the property, but often they are unable to raise the finance beyond the expected figure of £2,500 from their own resource.

These problems result in an inability to sell, and as a result young families are now being housed in developments which were built without the necessary amenities for that type of occupier. This in turn will lead to the social problems which come from poor housing conditions. It is not just the quality of the home which creates poor housing conditions, it is a lack of infrastructure such as adequate health, educational, and leisure facilities.

Although well intentioned, it can be hard to see how these schemes have provided value for money for the public purse.

**Institutional finance for the Private Rented Sector** has been a governmental aspiration for several years. This topic featured in the Rugg and Rhodes review of the Private Rented Sector in 2008.[11] Institutions have responded with various barriers to investment; and these have included:

- Stamp Duty Land Tax on bulk purchase, albeit this has been addressed by the Government's changes. However not a single Real Estate Investment Trust has been created for solely residential property. This has been totally the opposite experience to the success of Business Expansion Schemes available in the late 80s to the mid 90s. These historic schemes were a more suitable tax effective vehicle for institutions.
- The inability to reclaim VAT on repairs.
- The very small margin between rental yield and management costs including VAT. With gross rental yields being in the region of 5% the net yield can be in the region of 1% before allowing for any capital gain. The capital gain itself can be difficult for institutions to predict. Currently there is a very restricted re-sale market for this type of development and this prevents institutions from having a managed exit strategy. There have been suggestions that a derivatives market could be created, although many observers fear that would have many of the same types of problems associated with the sub-prime market.

An institution would require a medium to large number of units in any development. This doesn't fit with the scale required by the Private Rented Sector which typically is small developments or single units, the notable exceptions being student accommodation and rented retirement property.

Another barrier is the perception of reputational risk. Institutional investors require similar numbers of properties as Registered Social Landlords, and the problems RSLs face are well documented. This could impact on the institution's other products and services

**Stamp Duty Land Tax** reform is something we have continually asked for in conjunction with several other bodies in our pre-budget submissions to H.M. Treasury. Set out below are some of the key points we have made which we feel are still relevant today as part of the financing issues around housing in general.

*Thresholds are inflexible*

By not raising the stamp duty threshold in line with property prices, the tax yield from residential stamp duty has grown ten-fold since 1996–97. Between 1997 and 2008 receipts from Stamp Duty grew from £675 million per annum to £6.68 billion. While the impact of the tax may well have been offset by continually rising housing prices, in times of falling property prices it has the opposite effect. The "fiscal drag" of the tax is therefore exacerbated in an economic downturn, whereby static or falling house prices mean that this increased burden is not offset by an expected rise in value of the property. The current system makes it difficult for government to project its own revenue streams due to the volatility of Stamp Duty returns. Stamp duty receipts fell by nearly a half in 2008–2009 from the previous financial year. While both residential and commercial property prices declined, the HM Treasury notes that the key driver of the sharp fall in the duty is the "historically low levels of transactions."

*"Slab" structure distorts the residential housing market*

As currently structured, the "slab structure" of Stamp Duty distorts the UK housing market. The "slab" structure of the tax, where rates are applied to the entire value of the property rather than the marginal value, leads to a sharp rise in the amount of duty payable as the price of a property moves from one band to the next. If a home moves beyond £250,000, for example, the rate of duty jumps from just 1% to 3%. This impacts the market for properties sold at prices just above the thresholds, rather than there being a smoother distribution of house prices as there should be in a well-functioning market.

[11] The Private Rented Sector: its contribution and potential. Julie Rugg and David Rhodes. Centre for Housing Policy, the University of York.

*First time buyers remain disadvantaged*

Stamp Duty places a disproportionate burden on first time buyers, which is of particular importance in the current climate where new buyers in the market are finding it difficult to gain a foothold on the housing ladder. First time buyers are more likely to be near their credit limit, particularly in the current lending environment. This means they are less able to extend their borrowing to cover the additional cost of stamp duty. Moreover, stamp duty is not index-linked to rise with inflation. This has meant that Stamp Duty has been paid by increasing numbers of first time buyers.

*Price ghettos*

Stamp Duty creates differences across the country. Regional house price differences lead to a geographical inequality—or "price ghettos"—in terms of who bears the burden of the duty. Stamp Duty falls more heavily on the south of England where prices are higher. This demonstrates the need to consider regional variation in the Stamp Duty thresholds.

*Effects on the wider economy*

The slowdown in the housing market has had considerable implications for economic growth. House building, renovation and associated industries are important providers of jobs and an important source of aggregate demand in the domestic economy. As first time buyers are usually the foundation of sales chains, reforming or extending the current Stamp Duty system will encourage additional stamp duty and VAT revenues generated in other sales and ancillary services.

*October 2011*

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## Written submission from Westminster City Council

*How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

With reduced levels of public subsidy available in future, we must make what we have go further. We see two potential means through which this could be achieved:

(i) through leveraging the public funds by attracting additional private finance, and

(ii) by supporting local authorities to build homes on their existing, extensive, land holdings.

Generally, the former will best be achieved by providing subsidy to the RSL sector which has the ability to access additional funding off the government balance sheet. By taking the price of land out of the equation, the latter has the benefit of significantly reducing the costs of development, thereby enabling more homes to be built for a given level of funding. Local authorities also have the advantage of being able to access sites that would be difficult for other organisations to develop.

As is argued later in this submission, freeing local authorities' housing activities from public sector borrowing restrictions would also increase the ability to access additional funds to support growth in housing supply.

Also the planning system needs to support delivery and the proposal to enable the change of use from business to residential property without planning permission will reduce the supply of affordable housing delivered and may prevent local authorities from securing their required mix of unit sizes in new residential conversions.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

Westminster Council has historically provided "top-up" finance (through our own Affordable Housing Fund, and alongside HCA funding) to make affordable housing schemes work. This is because the cost of land in Westminster is prohibitively high. In future we will move towards investing our Affordable Housing Fund as investment in order that the Affordable Housing Fund is recycled wherever possible. Nevertheless for S106 schemes, which predominate in Westminster, we expect planning conditions to be priced in by developers so the need for additional subsidy is minimised.

Investment in intermediate based affordable housing would create potential for investment returns linked to house price inflation. The provision of investment into intermediate accommodation provides the opportunity for time limited investment where returns could also be linked to stair casing and market sales on low cost home ownership products.

*What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening*

We would expect owners of public land to get a return on their asset. However where land is poorly used or is of low value, a proportion could be offered to enable wider redevelopment and regeneration.

*How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

Barriers to long term private finance in the private rented sector are widely reported to be:

- Low yields.
- High management costs.
- High transactional costs.
- Access to scale/large portfolios.

Residential property is a "lumpy" investment and building a portfolio of any reasonable size is difficult and costly compared with other investments to which large scale institutions or funds have access. While equities can be traded easily and at low cost (stamp duty at 0.5%, for example), property transactions are both lengthy and costly (stamp duty at up to 5%, for example). Such difficulties no doubt bar institutional investors from direct investment in the sector, however opportunities for indirect investment, eg through property trusts, are limited in the UK.

There is a need to challenge perceptions about low yields as there is some evidence that they compare well to other assets and capital growth has been strong for a decade. In Westminster, our market delivers high capital returns and low volatility and should be attractive to the industry and we have the scale—and capital that could link investors to assets.

Interest in models that provide affordable housing have focused on the intermediate sector and the City Council is considering how it can influence the delivery of a broader range of private rented intermediate homes. This includes through S106 negotiations and officers have commissioned some modelling work to look at, where scheme viability is at risk owing to the base affordable housing planning policies, whether time limiting use of intermediate homes as affordable housing to 15 to 25 years might ensure delivery and greater influence over factors such as size and affordability to households.

This has been informed by a commissioned study carried out by DTZ to explore the appetite of private sector investors and developers for providing intermediate rented homes. Interviews with 12 players in the residential property market found:

- The appetite for providing intermediate housing for rent chiefly depends on the level of social obligation and the return that can be delivered—and a healthy level of appetite was found.
- While two of the interviewees were averse to providing intermediate rented housing as this was not part of their core activities and wouldn't meet their minimum return requirements, all other commercial parties had an appetite provided returns were in line with other property sectors.
- The appeal of providing intermediate rented housing was enhanced by confidence in rising capital values in Westminster and a belief that voids will be lower due to the high demand.

*How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

One option may be for affordable housing voids to be temporarily released to the market thus generating increased revenue streams which could be re-invested in affordable homes—for example for bedsit and studio properties which can be hard to let.

*How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply*

The forthcoming reforms to the HRA subsidy system are welcomed by the City Council, as they will bring greater certainty regarding future income and enable us to plan to meet our housing investment needs for the longer term. In addition, we will finally be able to free up resources for much needed new housing supply in an area of very high demand. More could be done, however, by enabling local authorities to borrow above the limits to be set, providing prudential borrowing rules are followed.

The housing activities carried out by local authorities constitute a sustainable trading activity and there are arguments that such activity should not be counted within government borrowing limits. Current and anticipated restrictions on borrowing arising from the HRA settlement may pose a financial disincentive for local authorities to develop new supply due to:

- Reserve powers to cap local authority borrowing by government.
- UK centric fiscal rules about how debt is measured.
- Concern about the impact of further local authority borrowing on public sector debt.

- Uncertainty about the agreement of the abolition of the HRA subsidy system.
- Section 13 of the 2003 Local Government Act which restricts the ability of local authorities to ring fence any borrowing against the HRA.

The City Council proposes two options which would give local authorities greater freedom to borrow and fund new housing supply:

*Option 1*—that local authorities should be allowed to borrow against the value of future revenue streams within their housing stock and this should be accounted for outside of existing government Departmental Expenditure Limits (DEL), but still counted as part of public expenditure. Precedent exists in Scotland for prudential borrowing for local authority housing to be accounted for outside DEL, which provides freedom for Scottish Local Authorities to invest in new housing. To achieve this primary legislation would be needed to amend Section 13 of the Local Government Act 2003 which restricts local authorities' ability to secure borrowing against future revenue streams.

*Option 2*—that local authority housing is regarded as an activity outside the main public sector debt so councils would be brought into line with housing associations in their ability to borrow. Currently the UKs fiscal measurements include debt and borrowing of publicly owned trading bodies which are financed by their trading incomes—this is inconsistent with EU measures. Research has indicated that changing the rules would not be viewed unfavourably as the credit rating wouldn't be affected nor would the cost of borrowing. The rules could be changed by taking all the remaining trading bodies out of the government's main definition of public sector debt by adopting "General Government Gross Debt" as the main measure, rather than Public Sector Net Debt. Alternatively current UK debt measures could be retained but borrowing for local authority housing could be made an exception to it.

Further details are contained in the attached paper, *Strong Foundations for New Homes*, submitted to the Coalition government for consideration in March 2011.[12]

Additionally greater freedoms over rent setting would enable local authorities to plan better financially and meet local housing needs in a more sustainable way.

*How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term*

In principle the affordable rent regime is a good way of increasing funds available for new housing supply but it's effectiveness in central London will be restricted by:

- The proposed welfare benefit cap which is likely to make anything above target rents unaffordable to larger non working households in three plus bedroom properties.
- The need for Affordable Rents to be "affordable" to social housing customers and not reinforce long term benefit dependency. In Westminster our supported affordable rent levels reflect lower quartile to median incomes of households registered on our intermediate housing list. These are considered moderate incomes to which households eligible for social housing could reasonably aspire. They are significantly below 80% of market rates.
- The need to let Affordable Rent tenancies to households eligible for social housing which in the main have low incomes.

*October 2011*

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### Written submission from the Northern Housing Consortium and the North West Housing Forum

This is a joint submission from the Northern Housing Consortium and the North West Housing Forum. We represent almost 200 registered providers of social housing and Local Authorities across the three northern regions.

We are pleased to respond to the Committee's call for evidence into this topical subject matter.

#### Summary

Our submission covers three main areas:

- Need to support access to mortgage financing to stimulate a stagnating housing market—thus unlocking further supply opportunities.
- Securing new investment lines into housing delivery.
- Making better use of assets to maximise capacity to deliver.

[12] Not printed.

Introduction

The national requirement for new housing is accepted by all parties and yet supply is still not matching demands and rates of new build have been on a downward trajectory. This trend, coupled with wider economic condition, has restricted (although not removed) government finances directed at the delivery of affordable housing.

Current government policy is focused on incentivisation for new build—through New Homes Bonus, TIF, build now—pay later etc and in particular a call for better use of existing assets to support delivery and reduce direct government subsidy—through routes such as the Affordable Rents Framework.

Although initial concerns were raised by many Northern providers around the viability of the Affordable Rent proposals, providers in the North have worked collaboratively to develop innovative programmes and secured an increase in proportion of national allocation—intending to deliver 22% of outputs in this cycle compared to 14% during 2008–11 and securing an increased proportion of total investment—moving from 14% in 2008–11 to 22% in the 2011–15 programme. However, concerns remain as to the long term capacity of providers to develop in this manner and many organisations report they will be close to gearing ceilings over the course of this four year programme.

We welcome the principal of incentivisation into the delivery of new house building but felt that one of the current vehicles for incentivisation—the New Homes Bonus has limitations which need to be addressed.

Our submission focuses on three areas:

1. Improving access to the home ownership market—notwithstanding the need for a debate around the balance between rental and home ownership—it remains the case that many people aspire to home ownership and yet cannot access it. Building rates of new homes are affected by the speed in which sales occur and with sales in both "new" and "second hand" markets constrained we need to consider how to facilitate access.
2. Securing new investment sources into the delivery of new homes—particularly in the affordable housing sector, the cost of securing finance is increasing and the range of investors is reducing, compounding the problem yet further.
3. Better use of assets—Government expect housing providers to maximise the capacity of existing asset bases to improve the supply rate of new homes. The experience of the affordable rent framework suggests Northern providers are actively exploring how they can make best use of asset portfolios and our submission explores additional routes—although we acknowledge some have limitations.

1. *Improving access to the home ownership market*

Recent figures from the Halifax (October 2011) suggest that the average age of first time buyers (FTB) in the North is 28–30 and those seeking to purchase face an enormous challenge in terms of affordability—indeed the CML report that over 80% of FTB needed support from others with their deposit last year, compared to just over 30% in 2005.

First time buyers, according to a HBF report "Broken Ladder" from October 2010 highlights the difficulty in securing a deposit for FTB, citing the percentage of net annual salary to deposit for the three Northern regions as:

NE 168% NW 180% YH 179%

Those first time buyers—including many in the North—who do not have this financial support must wait longer to get access to a mortgage and we should consider new product development aimed at this market.

Following the global economic crisis mortgage availability has constricted considerably and those mortgages that are available are more restrictive.

Whilst not advocating a return to the days of 110% mortgages we do feel that sensible lending could be within margins of 90 to 95% mortgages and would ask the government to consider how it can encourage lenders to return to a more balanced view of lending. Some in the house building industry are calling on the government to provide a guarantee to bridge the gap between 90% and 95% mortgages. The house-building industry suggest this "guarantee" would be relatively low risk for the government as it would only have to pay this money in the event of default. We would welcome further analysis of this proposal to better understand how it could open up access to home ownership.

Over the past year new entrants (or returners) to the mortgage market have been Local Authorities, who have—either individually, or in collaboration with banks and building societies—used their financial assistance powers to support mortgage provision. The demand for these LA mortgages has been high and given the Housing Minister's support for these Local Authority mortgages, we urge the government to consider how it could expand these schemes—perhaps through pump priming with central government investment to reduce initial prudential borrowing requirements at a time when LA's have considerable financial constraints.

There are other financial models available that perhaps merit wider roll out—for example Hitatchi Capital in conjunction with Barratts, now offer a 12 year unsecured loan for parents to use as part of the deposit for first time purchases for their children. The purchaser secures an 80% mortgage, pays a 5% deposit and the remaining 15% is provided through the unsecured loan.

Innovative schemes such as Gentoo's Genie product is a strong response to the lack of mortgage availability—Genie is a means by which you can own your home without the need for a mortgage at all.

**Summary of Genie** www.justaskgenie.co.uk

A long-term structured payment plan, the Genie Home Purchase Plan enables purchaser to acquire a share of the home by making one residency fee payment each month.

The payment plan is flexible and lets the purchaser own up to 100% of a home over the 25-year term of the agreement. Access to the Genie does not need a mortgage nor a deposit.

Whilst current attention is focused on unlocking the stagnation of the housing market, we also need personal finance solutions that look to the horizon. Although the age of first time buyers has increased, there are further potential barriers. Young people entering university this year will be the first generation to leave with significant debt. It will not be uncommon for students to be graduating in their early 1920's with almost £30,000 of debt, we need to better understand how this level of debt will shape their housing pathways—will the attraction of home ownership further diminish and therefore do we need to consider more investment in rental models, or will the aspiration to ownership remain—in which case mortgage provision may need to adapt significantly to reflect the—by then—more commonplace levels of personal debt.

2. *Securing new investment*

In terms of lending to the affordable housing sector, traditional lending routes have constricted—this is as a result of wider global economic pressures but has led to a position of reduced lenders, shorter loan periods, repricing on loan portfolios and on some occasions enacting of covenants.

Housing providers continue to represent sound investment vehicles—although wider reforms around welfare may impact this. We would welcome steps by government to support the low risk perception of the sector. For example, in terms of macro-economic policy we would urge the government to consider how "credit easing" proposals can be directed to stimulate housing supply—perhaps through supporting and growing the corporate bonds market for SME's—including housing providers.

Outside of traditional lending, bond financing is increasing throughout the affordable housing sector—however these can be at a rate which is more expensive than historical levels which will have to be managed through greater efficiency gains or could impact on deliverable out turns.

We would welcome larger scale institutional investment into housing provision which has not happened at scale in the UK. Particular concepts that are emerging include lease backed funds which provide an alternative to bond finance. In this model, ownership of the scheme transfers to the investor and is leased back to the provider until the loan is paid. There are concerns around this model, particularly its ability to manage risk given turbulent performance of pension markets in recent year.

The NHC is currently exploring the potential offered by sovereign wealth routes. Whilst the UK has proven to be an attractive investment hub for sovereign wealth, it has historically been focused around London and initially was focussed into commercial rather than residential investment. However, in recent years we have seen this pattern begin to change with investment moving north and into Scotland—initially into commercial facilities but also into scaleable residential development—including student accommodation. Scale appears to be the primary issue in terms of securing investment and this would require collaboration across the affordable housing sector—we feel the NHC and NWHF are well placed to support such collaboration.

Developer led lease arrangements are also a model which could warrant further consideration—in summary the arrangements would see a developer building and owning the properties but leasing them on a 25 year lease to a registered provider. The provider would charge flexible rents and use this financing route to buy back the properties at the end of the lease period. A rolling development programme involving a consortia approach which includes a programme of asset balancing in this context may generate additional financial capacity.

Government policy has seen a switch to incentivisation via the New Homes Bonus, this additional source of investment has real potential to add capacity to new delivery. However, we do have some concerns regarding its possible limitations. In particular we have concerns that the long term funding of the scheme via top slicing of formula grant will disproportionately impact on the North. We are calling on the government to fully fund the scheme from Treasury to ensure that investment in supply is provided throughout the country.

3. *Better use of assets*

The government is expecting the affordable housing sector to make better use of its asset base in building a platform for new delivery.

Active asset management is being progressed by many providers and modelling suggests that in some parts of the country 0.4–1.5 additional properties can be delivered for each unit migrated to alternative tenures or disposed of. Clearly for migration to be viable, the issues outlined previously around access to mortgage finance—or the development of new models—must be progressed.

Understanding asset capacity is limited when considered in a single organisation perspective—greater capacity is likely to be generated when worked across a sub region—or even region. Providers in the NW explored this approach in advance of the Affordable Rent framework, however it was not possible to secure a new model of asset maximisation and recycling. It may be timely for this debate to return—supported by the HCA with their capacity via land and RDA asset management.

Strategic asset management across the wider public spectrum—building on the total capital pilots—may provide considerable additional capacity—some estimate that £2 billion capital and revenue savings could be generated in North of England if pilot activity was rolled out. Whilst this approach looks to provide significant capacity, inevitably the scale of collaboration required will mean this is a medium term approach.

### Conclusion

Stimulating housing supply will support economic growth strategies and it is imperative that the Government work across the housing supply sector to explore all opportunities that could unlock barriers.

However, we are conscious that policy development needs to be attuned to geographical and economic conditions across the country.

Members of the NHC and NWHF are committed to working with government to explore innovative approaches along the lines highlighted in our submission.

*October 2011*

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## Written submission from Riverside

### 1. Summary

1.1 Any attempt to improve the financing of additional housing supply needs to be based upon a business model which is sustainable in the long-term, and transparent about the subsidy required to ensure the homes delivered are affordable. We do not believe that the Affordable Homes Programme in its current form represents such a sustainable model, and would urge Government to commission a thorough review even at this early stage.

1.2 We believe that any credible system of provision of affordable housing requires significant subsidy. This can be delivered in a range of ways, however we believe a system based upon more generous supply side subsidy (upfront grant) represents the best way forward, given:

- uncertainty over long term revenues because of the need to contain the welfare benefit bill;
- the condition of financial markets in general; and
- the opportunity to provide an economic stimulus through increasing supply.

1.3 Lender (or investor) confidence is paramount, and we find the approaches of CLG and DWP strangely at odds, with one attempting to stimulate delivery through a high-risk model based upon increased revenues, and the other trying to contain revenues through fundamental welfare reform. This contradiction needs resolving.

### 2. Introduction

2.1 The Riverside Group is one of the country’s largest and longest established housing association groups, owning and managing over 50,000 homes. We provide a mixture of social and non-social rented homes and housing for low cost home ownership. The Group welcomes the opportunity to provide a memorandum for the CLG Select Committee’s inquiry into new housing supply.

2.2 Riverside has been providing affordable housing since 1928 and over time we have adapted to provide new homes under a range of funding regimes. We have managed to balance a very strong track record for governance and viability—we currently hold top regulatory ratings for both—with an appetite for innovation and appropriate risk taking.

2.3 The size of the organisation has doubled over the past ten years, both through the development of new homes and growth through local authority stock transfer, merger and PFI. Over the past three years alone we have built over 2,000 homes for rent, affordable home ownership and outright sale.

2.4 At the same time we have been undergoing a process of significant stock rationalisation, to ensure we maintain a “footprint” that enables us to provide efficient services to tenants, and focused leadership in the neighbourhoods and communities in which we work. This has resulted in the disposal of 2,700 homes over the

same period, mainly to other housing associations, although this has also included sales of some long-term empty properties to individuals through our discounted home ownership scheme "OwnPlace".

2.5 We have been able to deliver new housing through a range of routes including:

— The HCA's National Affordable Housing Programme, leading the largest development partnership outside London and the South East (by grant allocated) under the 2008–11 programme.

— Working with private sector house builders to deliver homes through s106 agreements, particularly in the Midlands and North East of England.

— Developing housing for outright sale through our commercial development subsidiary Prospect, which has recently increased its capacity by acquiring a series of strategic sites from a private sector developer.

— Building further affordable housing in genuine mixed tenure communities through Compendium, our joint venture with house builder Lovell, with live projects in Stoke on Trent and Liverpool, and a major project planned in Derby.

— Building new homes, and refurbishing council housing, through two Private Finance Initiatives in the Midlands.

2.6 In order to maximise our financial capacity to enable us to develop more homes and provide better services, we have implemented major changes to the governance of the Group via a process of statutory amalgamation which has brought all the significant assets of Riverside into the same legal entity. We have also restructured our operations to deliver efficiency savings of over £2 million pa.

2.7 We believe we are well prepared to continue to build more homes and provide improved services, even in these challenging times. Drawing upon our direct experience, this memorandum addresses two of the specific lines of inquiry identified by the CLG Select Committee. It is structured accordingly.

3. *How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term*

3.1 We believe that we have developed a sustainable approach to development which balances an appropriate appetite for risk characteristic of a successful property developer, with the long-term, customer-orientated view of a charitable housing association. This has been recognised by our regulator, the Tenant Services Authority. Whilst it is hard to talk about a "typical" housing association in such a diverse sector, our experience might be regarded as a useful barometer to help judge the sustainability of the Government's new funding approach.

3.2 Our experience of the bidding process for the Homes and Communities Agency's Affordable Homes Programme has been challenging. Despite the short term national headlines, we think our own position illustrates some weaknesses in this new higher risk model, which has shifted the balance further away from up-front capital subsidy, to long term revenue funding. This places a far higher reliance on private finance at the very moment the lending market is contracting and future rental streams are at risk because of welfare reform. Whilst to date, the HCA has published no information on the relative "fortunes" of other established providers, we would be surprised if our experience is unique.

3.3 The original Riverside "offer" to the HCA under the Affordable Homes Programme (2011–15) was based on the following:

— Maintaining our development momentum[13] through the delivery of 1,600 new dwellings (predominantly for rent) over three years in five regions. This would have required £36.5 million HCA grant, and £122 million borrowing and sales receipts.

— Delivered through very competitive build costs—a 5% reduction on current prices—because of effective procurement through a framework arrangement.

— The use of other resources, including recycled grant accumulated from previous property sales, and subsidised land delivered through s106 agreements. A fifth of our "offer" was on a nil grant basis.

— An imaginative approach to the setting of Affordable Rents for both new homes and re-lets, based upon a mechanism which "caps" 80% market rents to ensure they are affordable to both those in work (based upon 30% of the 30th percentile of local gross household income) and those on benefit, reflecting likely changes being introduced through the Welfare Reform Bill.

— Cautious but credible financial modelling assumptions, given impending welfare benefit changes, longer-term political uncertainty over rent setting and the imperative to avoid the excessive leveraging of our balance sheet.

3.4 We believe we submitted a credible, rounded bid, requiring an average grant per unit of £23,000, representing a reduction of 60% on the previous three year programme. However even then, the borrowing required would have taken our gearing[14] substantially closer to the maximum level permitted in the legal covenants set out in our loan agreements. In other words, at the end of the programme we would have found it difficult to create significant further development "headroom", without renegotiating our loan covenants.

[13] Albeit at a lower level, with "outputs" reduced by 20% compared to the previous three year period.

[14] Gearing is a measure of borrowing as a % of the total asset value measured in relation to grant plus reserves.

3.5 The HCA's response to our "offer" has been an allocation of funding to deliver fewer than 600 units—less than 40% of Riverside's original offer. Whilst in one sense this leaves much of Riverside's remaining development capacity intact, it is still disappointing.

3.6 We believe that the HCA allocation was driven by a number of factors:

- Our programme required a marginally higher than average level of grant per unit. The programme attracted a significant number of new entrants who were able to bid on a very low or even "no" grant per unit basis, offering free land, and taking up the one-off opportunity to increase rental income from a low base. The programme is likely to be successful in unlocking their financial capacity on a one-off basis, and whilst there were elements of these approaches in our own bid, the extent to which we were able to do this was limited by our own starting point.
- It relied on a high proportion of conversions of re-lets to Affordable Rents to the scale of new provision proposed, partly because of the impact of "capping" affordable rents to ensure affordability, particularly in higher value parts of the country.
- Our offer was underpinned by a cautious, long-term view of development and the risk involved. In particular we took a relatively conservative view of the longevity of the affordable rent regime (ie the length of time we will be able to charge the new, higher rents), and the likely impact of welfare reform. Very aware of our gearing covenants, we also took an approach which ensured we would have some remaining development capacity at the end of the three year funding programme.
- Our offer was based on a national approach in which we tried to use the advantages of scale and operation across a range of housing markets to take a "pooled" approach to resources, costs, income and subsidy. However whilst we had to submit a single offer covering the whole country, the advantages of this national approach were lost as we were still required to isolate individual regional bid lines and make each one deliverable in its own right. This has led to a situation where we received no allocation to develop in an individual region where we had a strong track record of competitive delivery.

3.7 We accept that the programme is likely to be successful in unlocking the development capacity of a number of new developing organisations, at least for a period of time, and has been less suited to our own unique circumstances This approach may well be necessary at a time of exceptional public funding constraint, however it is worth reflecting on the underlying issues, and what they say about the new model as an approach to funding new development in the longer-term. We have drawn a number of important conclusions:

- Despite headlines, the Affordable Homes Programme in its current form does not provide a sustainable future for the provision of sub-market rented homes.
- Whilst it is possible to incentivise the "sweating" of assets on a one-off basis, many contributions to the programme use finite resources—free land, the capacity to increase rents from relatively low levels, recycled grant, and the value of balance sheets. We believe that it will become more difficult, if not impossible, to repeat this approach.
- It is impossible to reduce up-front subsidy by more than half to a grant rate of c20% without significant effects into the future. The economics of the development of affordable homes at these grant rates simply doesn't work, even with higher affordable rents, and whilst there is some capacity to reduce grant rates from those enjoyed under the previous National Affordable Housing Programme, especially given a higher rent regime, a more sustainable figure lies somewhere between the two. Maintaining the current rate into the future will only result in the rapid depletion of finite resources, the very antithesis of sustainability. Whilst this approach may suit a uniquely tight set of fiscal circumstances, it is essential that the real impact is widely understood, and that there is no illusion of success.

3.8 A model which relies on the potentially dangerous leveraging of the balance sheets of not for profit providers must set alarm bells ringing, particularly as regulatory capacity is scaled back. The recent report published by L and Q and PWC[15] estimates that in order to deliver the programme and other important financial commitments, providers will see their gearing increase to 95% without significant efficiency savings. Arguably, efficiency savings will be "wiped out" by the need to increase bad debt provisions as a result of welfare reform.

3.9 We urge the CLG Select Committee to recommend that the Government commissions an independent interim impact assessment of the Affordable Homes Programme, even at this early stage of delivery, to inform planning for post 2015. This assessment should consider:

- The total public subsidy consumed by the Affordable Homes Programme in terms of capital grant, increases in housing benefit associated with the affordable rent regime, and the value of "in kind" contributions such as land and recycled grant. This review should assess whether the programme really delivers better value than the previous National Affordable Housing Programme.
- The geographical distribution of subsidy (again capital, revenue and in kind) and the success of the model in delivering homes in different geographical locations and housing market situations.

[15] Where Next? Housing after 2015, L and Q Group/PWC.

— The potential weakening impact on providers' financial capacity as measured through their balance sheets (gearing), and I and E accounts (interest cover), and the extent to which the programme is repeatable given competing priorities for resources.

— The impact of the programme on the views and activities of lenders, and on the credit ratings of providers (when seen in conjunction with welfare reform).

3.9 Our final observation on the programme is that there remains a mismatch between the principles that underpinned the original vision of Affordable Rents and the reality. This manifests itself in two important ways:

(a) The new approach was brought in under the banner of "freedom and flexibilities", encouraging consortium working and bold approaches to longer term planning. We initially saw this as a great opportunity, securing longer term funding commitments and working to maximise the buying power this would bring which would lead to increased efficiencies. Unfortunately the process has conspired against any real flexibility. The HCA's Framework Delivery Agreement is a straightjacket that limits flexibility and speed of reaction through a complex system of "Programme Change notices", and this ultimately informed the degree of caution that underpinned our bid. A review of the programme should address the extent to which the mechanics of its administration has tempered appetite for risk.

(b) The concept of charging higher rents to those who can afford more appears reasonable and in keeping with the earlier "intermediate rent" system. However this issue has been fudged and the guidance is clear that allocation of affordable rents must be on the same basis as social rents. So far from opening up a new market to provide for a less benefit dependent customer group, the Affordable Rent system has become a new, expedient way of funding an old product. This means that calculations about the future reliability of income streams in the context of welfare reform have also driven caution.

3.10 If these two issues could be resolved then the longer term framework developed could have a place in helping reduce procurement costs and reducing the subsidy needed to house people who can afford to pay more than social rents.

4. How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply.

4.1 In order to increase the amount of private finance into the supply of affordable housing, providers require two things:

(i) An income stream that is sufficient to meet increased loan repayments which are inherent in the affordable rent model, to create a balanced and sustainable economic model of provision (see 2 above); and

(ii) An income stream that is reliable over the long-term in a way which engenders lender confidence, particularly as the traditional lending market contracts. There are far fewer lenders active in the UK social housing market, compared to five years ago.

4.2 On the former (i) we have already argued that it is impossible to deliver affordable housing at any scale without some form of subsidy—either capital (supply side) or revenue (demand side), or a combination of the two.

4.3 Some economists would argue that for housing, demand side subsidy is generally more efficient than supply side, and can be better targeted at the households who need it most, for the time during which they need it. But this is only the case in a functioning housing market where supply responds quickly to increased demand, and prices are stable. This is not the position we have in the UK, and a model which increasingly relies on demand side subsidy (ie increased rents covered by the benefit system), will not necessarily yield the private finance required as providers become increasingly leveraged and cautious, and Government becomes increasingly anxious about containing the welfare benefit bill.

4.4 In these circumstances we believe a funding model based on adequate supply side (capital) subsidy is likely to be far more effective, and will better retain the confidence of lenders and other investors who have already provided an unprecedented level of cheap private finance to the sector over the past two decades. Upfront capital subsidy not only ensures ongoing affordability, but rapidly stimulates supply which brings wider economic benefits in a flagging economy. A 2009 study commissioned by the UK Contractors Group[16] demonstrated that construction is one of the best ways of stimulating economic activity, estimating that for every £1 invested in construction the wider economy benefits to the tune of £2.84.

4.5 After the completion of the current Affordable Homes Programme, the Government needs to return to an approach which balances supply/demand side subsidy to deliver affordable housing, with grant rates returning to levels which enable providers to break even on their investment. This approach needs to continue until we reach a point where supply and demand are balanced—ie for the foreseeable future. This would require an increase in average grant per unit, although if the changes to the programme recommended in 2.9 are implemented, this would not necessarily be to previous levels under the NAHP.

[16] Construction in the UK Economy: The Benefits of Investment, LEK, 2009.

4.6 On the latter point (ii), providers (and their lenders) need to be confident in their long-term rental streams. There are two elements to this:

— There needs to be a clear national rent policy. Having had the certainty of the target rent system for practically a decade, and a system of inflation pegged rent increases, a new two tier system (target and affordable) has emerged. Whilst initially the Government seemed to be heading in the direction of a gradual conversion of the majority of social tenancies to higher affordable rents (at least for developing providers), our experience of the HCA Affordable Homes Programme suggests that this is no longer the case, and that conversions to Affordable Rents are being severely rationed because of the impact on the benefit bill. We believe that this approach is not sustainable and the Government needs to make up its mind on its long-term approach to rents and future increases. Whilst the current four year guarantee on rent increases is welcome, we need a longer term approach with better joined up thinking between CLG and DWP.

— The threat of further welfare reform overshadows longer term confidence. The benefit system for social housing (post introduction of universal credit) needs to be underpinned by a long-term commitment to pegging benefits to actual rents. Again the Government's current position is ambiguous. In the short term the link between housing benefit and actual rents is maintained, however the Welfare Reform Bill as currently drafted will enable separation. Indeed in the Universal Credit White Paper the Government has only committed to maintaining a housing element (for social housing) which is pegged to actual rents in the "short to medium" term, and any eventual separation—for example a system of fixed rate payments pegged to CPI similar to the Private Rented Sector—would be disastrous for the sector and the future of affordable housing supply.

4.7 In addition to these longer-term risks, the "known" changes to housing benefit set out in the Bill are likely to cause significant problems for providers seeking to secure private finance at favourable rates. The proposed end of the option for the majority of tenants to choose to have their benefit paid directly to their landlord is likely to lead to increased rent arrears and bad debts. A recent survey commissioned by Big Issue Invest[17] reveals that 93% of social housing tenants questioned think it is better to have their benefit paid directly to their landlord, with 35% saying they would not be confident in being able to keep up with their rental payments if the direct payment option is removed. This has not been lost on lenders, who are campaigning hard against this change through the CML. It is only a matter of time before credit ratings begin to decline, and the price of private finance (where margins have already crept up) increases further.

4.8 In addition the proposal to restrict housing benefit for those under-occupying their homes (with little prospect of downsizing) will further undermine income streams. At Riverside we estimate that around 7,000 tenants will lose around £4.5 million of housing benefit per annum after 2013. As a result, we have doubled the bad debt provision in our business plan from 2013 to a figure which, ironically, is greater than the additional level of affordable rent we would have generated from the 1,600 unit programme of our original offer to the HCA.

4.9 Whilst there is considerable debate about future markets for private finance—whether they are traditional bank lending, the bond market or even the introduction of equity investment—it is important to recognise that they all rely on sufficient and secure income streams on the part of the borrower. There is a danger that the debate moves to the form of funding or investment, without the more fundamental questions of development economics being resolved. For example traditionally equity has been a more expensive form of financing than debt, and whilst the notion of an entirely different funding model may be seductive, potentially it increases, rather than reduces, the need for subsidy.

4.10 Ultimately, we believe that the best way to increase the amount of private funding going into affordable housing supply at a time of heavy rationing—whatever the form of borrowing or investment—is to ensure that the model of provision recognises the need for ongoing subsidy and certainty of rental income streams. It is this that has led to unprecedented private finance investment in social housing (over £60 billion) and we prejudice this at our peril. History suggests that housing providers and investors can and will be innovative, and find new sources of funding for the sector. However this will only happen, if the fundamental building blocks of a sustainable business model are in place.

*October 2011*

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[17] Social tenant attitudes to payment of housing benefits direct to tenants, Policis, 2011.

## Written submission from G15

The G15 is a group of London Housing Associations. We are independent social businesses which invest our profits back into building new homes, improving existing homes and delivering services to our residents and neighbourhoods. Between us we house one in ten Londoners.

The G15 are all major developers of new homes. Under the Affordable Rent Programme we have been asked to deliver 60% of the new social housing homes in London but we have interests in all housing tenures.

The National Housing Federation has provided a separate submission to the Select Committee which we support. However, there are additional London issues that we wish to make you aware of:

1. The biggest issue for London is supply. The need for additional housing in London is far stronger than any other part of the Country. The shortage expresses itself in many ways:
   - Increasing property prices.
   - Increasing rents in the private rented sector.
   - Increasing homelessness.
   - Increasing overcrowding.

   These problems are not going to go away. We are genuinely concerned about where the young Londoners are going to live.

   Urgent action is needed to encourage development of new homes of all tenures to meet these needs.
2. Welfare Reform, and in particular the £26,000 cap on benefits, threatens to drive existing residents out of the private rented sector and turn landlords against letting to those who are on benefit or at risk of being on benefit. This is a huge risk to the structure and future of London. In social housing it is also leading to the new affordable rents being higher for smaller homes than larger ones. Housing & Welfare strategies need to be aligned.
3. London is the heartbeat of the UK economy. The lack of Housing gets in the way of the economy growing. Social housing in particular helps make London a collection of mixed, diverse communities with people able to live near where they work. Without this supply of homes where will the low paid workers and the unemployed of London live?
4. There are lots of sites in London with planning consents but many of these are undevelopable. This is because:
   (a) The consents were granted prior to the crunch and the recognition by developers that there was an over supply of flats in some locations; and

   (b) Many are high density and/or high rise schemes where the developer has to build out the whole site before receiving any sales income. Not many developers can fund such schemes and the banks no longer provide 100% funding for any schemes.

   The supply of genuinely developable land is low and action is needed to increase the supply. The Government often talks of releasing its own land supply but action on this has been minimal.

   Making Government land available at a time when it is difficult to borrow and there is a shortage of grant funding is even more critical.
5. The Affordable Rent Model is positive as it keeps the supply of homes at a time when the Government does not want to invest much money in housing. However, it is not a sustainable model because:
   - For every £1 of grant, housing associations have to provide £6 of private finance. Within the G15, this is estimated at £2 billion between now and 2015. This uses up the capacity of many housing associations and they will not be able to repeat the Programme post 2015. There must also be questions about the supply of private finance to fund the programme nationally.
   - The move to higher rents is working counter to attempts to reduce the cost of welfare. We can only see the benefit bill increasing under the new model.

   Genuinely affordable homes need more subsidy than is being provided at present.
6. Many have talked about the need to get the Pension funds and other institutional investors into housing to help create a large, professional private rented sector. We would welcome this too, but to date they have not seriously entered the market because of their need for higher yields and their desire to avoid development risk and buy completed products.

   If it is not the pension funds, the developments will need support from the banks, and as stated above this is restricted. Some housing associations may be able to play a role but this will be limited as our financial capacity is reducing rapidly under the Affordable Rent Model.
7. In the owner-occupier market, 60% of sales are to people based overseas. We would not want this stopped as it enables the provision of some supply, but the availability of mortgages is a key barrier to housing sales and especially the high cost of deposits in London. A plan to support first time buyers back into the market is desperately needed.

Within the sales market, shared ownership continues to play an important role. Without it, more would become dependent on social housing.

8. Some have suggested the conversion of Government grant into equity as a solution to our capacity challenge.

   There are different views on this within the G15 but equity investment has to be repaid. It can increase capacity but it will also increase cost. This is no replacement for grant investment.

In conclusion, urgent action is needed by the Government to help increase homes for sale and rent. There is no free solution for Government. New money is needed to help people access owner occupation, encourage a bigger better private rented sector and provide more social housing.

*October 2011*

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## Written submission from Waterloo Housing Group

### Executive Summary

1. This submission to the Committee is from Waterloo Housing Group ("WHG"), a housing association registered provider ("RP") and one of the largest developers of affordable housing in the Midlands.

2. RPs' development activity is currently constrained by a heightened need to maintain margins of comfort over bank loan covenants, in order to avoid re-pricing of the substantial amount of low cost debt finance on balance sheets. In consequence, surpluses earned from property sales activities, an important element of development project financing, cannot be exploited to the maximum potential and sales risk exposure in general must be reduced.

3. Better use could be made of the £42 billion of public Social Housing Grant ("SHG") embedded in RP balance sheets. Controls on historic SHG should be removed, or grant should be converted to equity, to enable RPs to release property equity and attract more flexible private finance for the provision of additional affordable housing.

4. Using new RP controlled entities, new SHG allocations could be leveraged with both private equity and debt to sustain or increase housing output at current SHG rates. The obligation to repay SHG on sale of a grant funded property should be subordinated to equity investors' interests as well as that of secured lenders, with returns on equity restricted in return for this concession and consequent much reduced investment risk. A real terms equity return of around 5% p.a. on 20% project equity finance would, combined with current levels of SHG, enable the current programme of mixed tenure housing to be sustained beyond 2015.

5. Taxpayers should expect a return of over £2 billion per year on SHG invested in RPs since 1974. The Homes and Communities Agency ("HCA") should be empowered to collect this return in cash from RPs that are unable or do not wish to use their financial capacity, with proceeds directed to those best placed to invest.

6. The current HM Treasury review of Real Estate Investment Trusts ("REITs") should, combined with SHG reforms, create a framework that RPs can engage with to release property equity, attract more private finance, and provide more new homes.

7. RPs should be empowered to provide more flexible forms of shared ownership housing which ought to remain eligible for SHG support and be capable of attracting private equity investment in order to better meet prospective home owners' needs and to circumvent the current lack of affordable mortgage finance.

8. Local authorities and other public bodies should be incentivised to work in partnership with RPs by releasing land for development and deferring payment so as to better match this with scheme sales cash flows. These arrangements enable RPs to increase their output of new homes, potentially with lower levels of SHG.

9. Some legal restrictions placed on RPs created to receive the voluntary transfer of local authority housing serve no useful purpose given that these mostly charitable bodies are already highly regulated; their removal would help increase the supply of new housing by enabling the true value of housing stock to be used to secure loans.

### About the Submitter

10. This submission is made by Waterloo Housing Group Limited. The Group comprises four charitable housing associations ("Registered Providers—RPs") that together own or manage 18,000 homes across the Midlands region.

11. The Group is a long established major developer of new affordable housing with a significant annual output of new homes from our mixed tenure programme. We have received the largest single allocation of SHG (£39 million) in the Midlands, to develop 1,645 new homes over the period to March 2015 and will supplement this with other initiatives to provide additional housing in the region.

Context

12. RP housing development activity has typically comprised a mixture of housing tenures: predominantly social rent, shared ownership and outright sale with surpluses earned on the latter two categories used to cross subsidise the capital cost of the former. For many years now SHG received has not been sufficient to finance the provision of new social, now affordable rented housing without these cross subsidies.

13. Since the introduction of mixed public and private financing of RP housing development under the Housing Act 1988 the SHG component of scheme financing has progressively declined and RPs have responded by increasing their private debt levels.

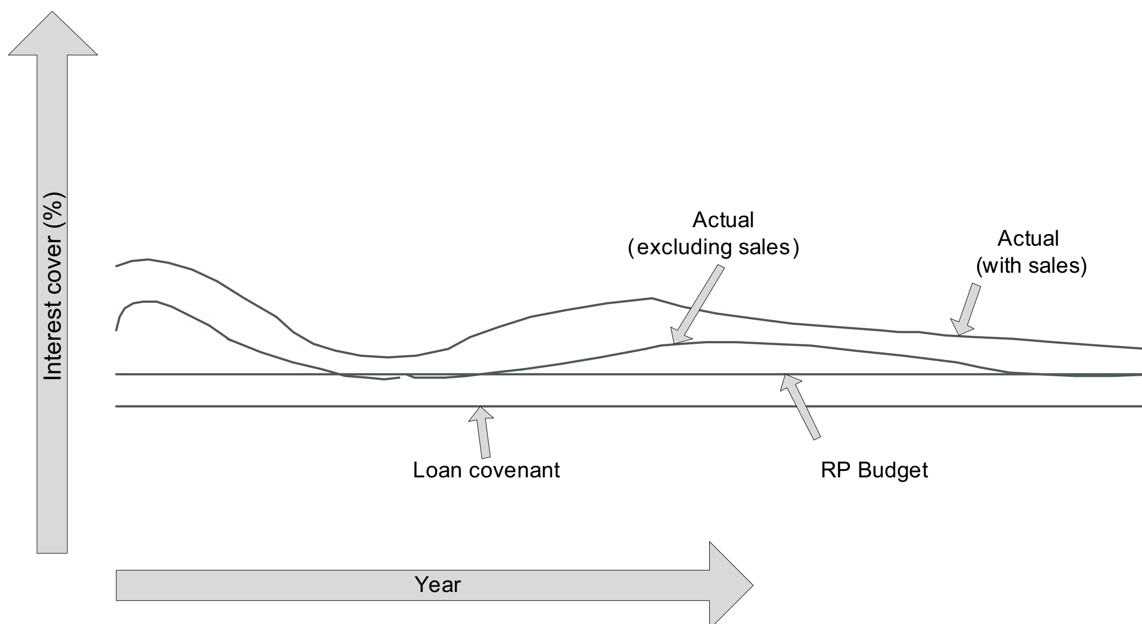
14. Prior to 1988 RP balance sheets contained a modest amount of publicly funded loans for housing development, with most of the cost of housing property assets funded by SHG. This balance has now changed although many RP balance sheets record substantial levels of SHG received over the years, eg WHG's £750 million gross cost of housing properties has been part financed by SHG: £310 million and loans: £370 million.

15. To date, the bulk of RP debt has been provided on a long term basis by banks and secured on housing property assets. RPs are obliged to adhere to a range of fairly conventional loan covenants in order not to default on their funding agreements. These covenants serve to limit the amount of additional debt RPs can take onto their balance sheets. The most important covenants which act as limiting factors on business growth are interest cover and gearing.

16. RPs' core rental activities generate predictable and stable cash flows and it is fairly straightforward to forecast interest cover covenant compliance with considerable accuracy if reliance is placed only upon this income. Property sales cash flows are inevitably less predictable and much more volatile, so this income is often excluded from interest cover covenants agreed with banks. Even if not specifically excluded, prudent financial management requires that no reliance be placed upon such cash flows to meet loan covenants.

**Graph 1**

TYPICAL REGISTERED PROVIDER INTEREST COVER PERFORMANCE



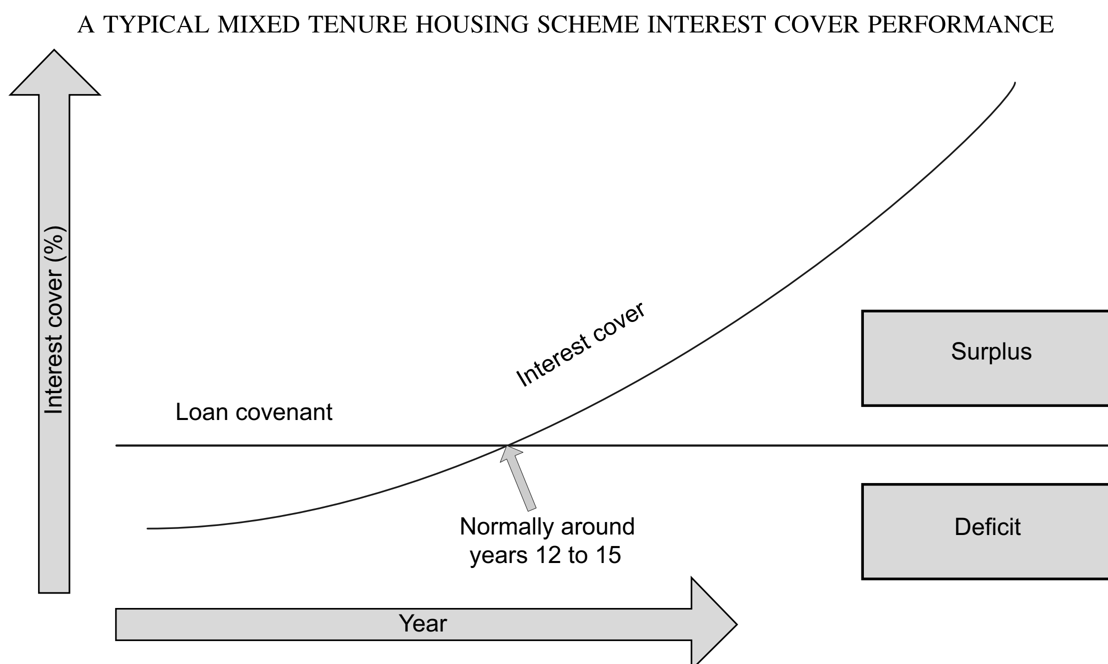

17. Prior to the 2008 credit crisis bank finance was readily available at low cost. Since the crisis and the related material increase in banks' wholesale cost of funds, most existing loans to RPs are now unprofitable for lenders. Whereas prior to 2008 breach of a loan covenant could often be remedied by negotiation with the relevant lending bank at no or minimal cost, now it can be expected to result in very expensive re-pricing of existing debt with a potentially serious impact on capacity to provide new housing. Debt re-pricing from historic to prevailing market levels could easily eradicate most, if not all, an RP's annual surplus. In consequence, RPs now take a more risk adverse approach to development growth, with increased comfort margins to allow for the uncertainty inherent in the process.

18. Most bank loan covenants operate at a corporate, whole business, rather than project level. A typical viable mixed tenure new housing development will, alone, fail to deliver financial performance that can meet these corporate interest cover and gearing tests. It is normal for schemes to record deficits in the early years after construction, offset by later years' surpluses. An important feature of the business therefore is that new housing developments require cross subsidy from surpluses and balance sheet capacity generated by other, mature assets in order to meet corporate loan covenant levels.

19. From the above it can be deduced that the maximum sustainable level of new housing development for any RP is a function of both the cost, tenure mix and funding of new projects, along with the strength of the existing business and its capacity, through surpluses generated, to sustain normal early years deficits on new developments.

**Graph 2**

A TYPICAL MIXED TENURE HOUSING SCHEME INTEREST COVER PERFORMANCE




20. Our recommendations for action reflect this operating context for RPs.

21. As discussed below, in furtherance of its objectives, we believe that the Committee should recommend action that seeks to:

- enable RPs more fully to exploit property sales revenues at an earlier stage, without prejudicing loan covenant compliance;
- attract equity finance into the RP sector;
- make better use of historic Social Housing Grant on RP balance sheets;
- increase the range of home ownership options offered by RPs;
- encourage public sector bodies to provide land in support of RP development; and
- remove some restrictions placed on stock transfer RPs.

## Recommendations for Action

*Attracting private equity to finance new house building*

22. SHG is repayable to the Homes and Communities Agency (HCA) if a property part funded by grant is sold; although repayment is not required if the grant is recycled for an approved purpose, usually the provision of a new affordable home in replacement of that sold. This obligation to repay or recycle SHG is subordinate to the interest of a secured lender, which has served to help attract private loan finance into the sector. In a default scenario the secured lender has a priority call on all the proceeds of disposal; the HCA is only repaid if the residual sale receipts are sufficient.

23. We propose that repayment of SHG should also be subordinated to the interest of equity investors or, potentially, providers of subordinated debt, with such finance raised via new subsidiary entities—probably companies limited by share capital—majority owned by RPs or RP controlled entities (this would need to be structured appropriately to ensure that consolidation of financial results does not create loan covenant breach within the RP). Equity investors and providers of subordinated debt would rank behind secured lenders in their ability to call on SHG to recover their investment after any default. Returns on equity should be capped as a condition of grant deferment, to reflect the nevertheless much reduced investment risk associated with this structure, effected via the HCA contract for SHG allocations. The RP would remain accountable to the HCA for the grant.

24. Given normal long term market value growth trends, at least in line with earnings, these vehicles could be re-financed in due course with SHG repaid to the HCA for recycling and with restrictions on equity returns

removed, subject to protection of tenants' interests. The residual RP role might eventually just be that of property manager.

25. Based on our operating experience in the Midlands region, we estimate that if up to 20% of future long term project finance was derived from equity, with post tax real terms returns capped at around 5% p.a., we could at least sustain and potentially increase output of a conventional tenure mix of new housing development at the same SHG levels as allocated to us under the 2011–15 National Affordable Homes Programme. The market for this type of comparatively low risk equity investment would need to be tested in detail, but the working assumption of a return higher than the cost of bank debt but lower than conventional equity appears reasonable in relation to alternatives, particularly for more risk adverse investors.

26. Increased housing output is achievable because equity would be used to absorb the risk associated with the timing of property sales cash flows on the circa 15% of the development mix consisting of properties built for outright sale and 40% built for shared ownership. Loan covenants on core debt finance (up to 60% of development scheme funding) would be comfortably met from cash flows on the affordable rent properties developed, which would comprise around 45% of overall output. In this model equity returns would be closely related to the timing of property sales receipts, so investors would need to be prepared to accept some volatility in the timing of dividends.

*Making better use of Social Housing Grant on RP balance sheets*

27. As others have already observed, SHG on RP balance sheets is a "sunk cost"; it has served its primary purpose of funding the provision of new homes.

28. Input of SHG to finance a social or affordable rented property should produce a gross rental yield in the region of 4% to 5% on investment cost, depending upon the relationship between cost and value and rental tenure type, with a net cash yield, after operating costs but prior to loan financing charges, of at least 2% to 3% indexed in line with annual increases in RPI.

29. Given that SHG represents taxpayers' investment in RPs it is reasonable to expect this level of return on the £42 billion of historic SHG allocated since 1974. The taxpayer ought currently to expect a net return on investment in excess of £2 billion p.a., after RPI indexation.

30. RPs can legitimately claim that an acceptable return is being demonstrated when they are exploiting their balance sheet capacity to maximise the new provision of affordable housing, with surplus net operating cash flows after interest re-invested in housing developments and key financial ratios maintained at prudent, but not excessively strong levels. Some analysis and debate is required in the sector to determine what level of interest cover and gearing might be considered excessively prudent, after having due regard to RPs' pipeline financial commitments, therefore potentially indicating under-exploitation of financial capacity. It is important to understand the underlying trend of the business in making these assessments.

31. The global accounts of housing providers 2010 (*Source*: Tenant Services Authority) demonstrates that there is considerable variance between RPs in key financial measures such as interest cover and operating margin on an aggregated basis (eg interest cover varies from 103.5% at the lowest quartile, up to 246.5% at the highest) with some of the strongest interest cover ratios amongst the smaller RPs, many of which take a more conservative approach to development and use of private finance.

32. In cases where surpluses are not being re-invested in new provision and/or financial ratios are deemed to be excessively strong, it would seem reasonable for the anticipated return on SHG to be paid in cash to the HCA for distribution as additional grant to RPs that are better placed to invest. This approach would not threaten the independence of RPs but would make explicit the obligation to achieve optimum use of their publicly funded capacity. Real resources would be released through this approach, without any change in public sector borrowing. A consideration of the comparative value for money of RPs' services would also need to feature in the capacity assessment; consensus is needed in the sector as to how much it is appropriate to invest in enhancing existing services to current customers as opposed to the provision of new homes.

33. Even more new housing output could be achieved if restrictions associated with historic SHG on the balance sheet could be removed, or if grant was to be converted into a form of equity, so that the full potential of housing assets to provide collateral could be exploited, including through sale to non RP vehicles able to attract private equity. HM Treasury's current proposals for relaxing some provisions governing the operation of Real Estate Investment Trusts could potentially make these vehicles suitable for increased delivery of affordable housing, particularly if regulations governing REITS can be amended to accommodate the required RP development mix of housing for both sale and long term rent.

34. Our indicative model of a REIT structure suggests that for each existing housing property of an appropriate type and age sold into a REIT portfolio for affordable rent, sufficient surplus proceeds could be released to provide the equivalent of at least the current level of SHG funding towards a replacement property. A one for one replacement of properties could be achieved, therefore, without any additional SHG.

*Increased home ownership options*

35. Many households are unable to access home ownership due to the current lack of mortgage finance; this problem currently also impedes RPs' shared ownership and outright sales activities.

36. In addition, the current shared ownership product eligible for SHG support offered in the sector has a number of limitations: the minimum equity purchase is 25%; many otherwise eligible applicants struggle to fund deposits required by mortgage lenders; RP initiatives to help finance deposits are not accepted by mortgage lenders; the leaseholder takes on a full repairing lease irrespective of the share of equity purchased; and subsequent purchases of equity tranches are for a minimum 10% each time. We would suggest that the same level of SHG should be made available to fund a more flexible form of shared ownership product.

37. We have developed an "incremental ownership" model which we believe addresses the above shortcomings and offers real benefits as a new route to affordable home ownership. The key features are as follows:

- low initial minimum equity purchase of just 5%;
- initial cash deposit set at 5% of equity (equal to the minimum purchase);
- combined rent and repayment mortgage, a single charge, with all funding provided by the RP;
- a higher rent than under conventional shared ownership but total outgoings (mortgage, rent and maintenance) initially within 80% of market rent;
- total housing costs remain within 35% of applicants' net income;
- small incremental increases in equity shares—as low as 1% at a time;
- ability for the purchaser easily to reduce as well as increase equity owned; and
- a proportionate repairing obligation, pro-rata to equity purchased.

38. Various FSA and HCA regulations would need to be amended to accommodate this type of home ownership model but, if achieved, we are confident this product would provide a useful additional option alongside conventional shared ownership, helping to circumvent some of the obstacles of the current mortgage lending market and increasing access to home ownership. The model would also be suitable for part funding with private equity to supplement available SHG and increase total new housing supply.

*Provision of public sector land*

39. Waterloo Housing Group has forged mutually productive partnerships with local authorities whereby land is made available to us on a deferred payment basis. Payment is made over various periods after developments have been completed, designed to reflect the characteristics of scheme financial performance (paragraph 18). As planned sales are achieved, or scheme cash flows mature to the point where expected corporate loan covenant performance levels can be met, land payments are made to the local authority.

40. These arrangements enable us to produce materially more housing than would otherwise be possible, and with lower SHG levels. Local authorities benefit from both nominations to new housing and generation of New Homes Bonus income, some of which has been allocated to us as additional scheme subsidy, thereby further stretching limited SHG.

41. We would request that the Committee recommends local authorities should be encouraged, preferably with incentives, to promote many more such land partnerships with RPs. Incentives should be targeted at both District and County level authorities as it is now often the upper tier authority that holds most developable land. Other public bodies should also be encouraged to work with RPs to release value in their land holdings, using this land to provide more housing.

*Controls over transferred local authority housing stock*

42. Many larger RPs have been created since 1988 in order to receive the large scale voluntary transfer of housing stock owned by local authorities. These stock transfers have successfully raised a substantial amount of private finance and delivered major improvements to tenants' homes. The businesses also have the long term potential to apply their financial capacity to developing new homes. However the transfers are subject to legal restrictions, including the Secretary of State's control over stock disposals, which serve to depress the loan security value of ex local authority owned housing properties.

43. Extra value could be obtained from this housing stock if statutory and contractual controls over dealing in the transferred properties, rather than those intended to protect tenants' rights, were removed. A removal of restrictions would enable most stock transfer RPs to fully exploit their latent strength by raising borrowing in line with their debt service capacity. As highly regulated, mostly charitable bodies, it appears unnecessary to retain much of the current legal framework applicable to these stock transfers.

Conclusion

44. Our recommendations in this submission are based on our practical experience as major developers of new affordable housing in the Midlands. Much more work is required to produce models that can be

implemented and investor appetite would first need to be market tested for the type of low risk equity investment proposed. We believe that increased housing output is achievable with these new models. In addition to meeting more of the high demand for affordable housing, increased RP led construction activity would clearly provide a very welcome stimulus to the wider economy.

*October 2011*

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**Written submission from Southwark Council**

Southwark Council is pleased to have the opportunity to submit evidence to the Committee. Our response on the specific questions asked by the Inquiry is set out below.

Summary

The overarching vision and strategic objectives of Southwark's housing strategy 2009–16 are:

"To improve residents' lives by providing high quality homes and housing services that promote successful and inclusive communities":

1. Improve the quality of existing housing and use it more efficiently.
2. Increase the supply of good quality housing.
3. Enable choice while meeting housing needs.
4. Prevent homelessness and reduce the use of temporary accommodation.

Our response seeks to outline the strategic importance of meeting housing need to this authority largely by focussing on steps the council has taken in recent years to enable the continued development of new housing supply, particularly affordable housing. We have continued to make this a priority despite the challenging economic climate, in terms of general delivery and in continuing to progress the council's major regeneration projects at Elephant and Castle, Bermondsey Spa, Aylesbury Estate and Canada Water. We therefore feel that many of our approaches can be recommended.

Measures have included:

— Continuing the strategic approach to the use of council assets, as a key driver to enable regeneration.
— Targeting of additional council resources to assist the viability of major regeneration projects.
— Balancing the need for land receipts with achieving wider regeneration objectives.
— Supporting social grant for private development schemes where economic appraisals have shown the need for additional finance.
— Implementing planning policy that requires affordable housing on student housing developments where appropriate.
— Stepping up engagement with development partners, both Registered Providers (RPs) and private developers and the Homes and Communities Agency (HCA).
— Entering into long term strategic developments agreements with developers to secure certainty of delivery and long term vision.
— Setting out clear planning policies and guidance, and updating them where necessary.
— Reviewing the tenure mix of developments.
— Scheme review clauses in S106 agreements.

These measures have enabled the council to ensure delivery of affordable housing in the last few years, as shown below:

| | *2006–07* | *2007–08* | *2008–09* | *2009–10* | *2010–11* | *Total* |
|---|---|---|---|---|---|---|
| Social rent | 520 | 460 | 250 | 400 | 390 | 2,020 |
| Intermediate | 460 | 450 | 280 | 270 | 420 | 1,880 |
| **Total** | **980** | **910** | **530** | **670** | **810** | **3,900** |

The council has managed to exceed its affordable housing targets in recent years, including the 2008–11 Local Area Agreement (LAA) target. Southwark's LAA target for the period was 1,931 affordable homes and in the event, 2,010 homes were delivered. Throughout this period Southwark has consistently been one of the top deliverers of new social housing in London.

The response also highlights the particular characteristics of Southwark as a large stock holding housing authority with high investment needs. The council has agreed a programme to invest a minimum of £326 million in the housing stock over the next five years. Capital receipts from disposals have played a significant part in HIP resources for a number of years; consequently the council faces an ongoing strategic choice to balance the need to generate resources through the sale of housing assets to assist in funding this programme, against the need to use land value to assist with the viability of new housing and regeneration projects.

To meet the council's regeneration objectives and in order to drive renewal of our existing stock to address the high investment needs, there will be a continuing requirement for public sector support, together with investment that can be generated via the private sector and from land value. The regeneration of Aylesbury estate is an example of council's approach to tackle investment needs by a holistic regeneration to produce 4,200 new homes, a mix of private and affordable, underpinned by an adopted Area Action Plan. However, the response also highlights the need for a flexible and responsive grant regime is needed to address the up front costs of land assembly and infrastructure which need to be met to enable large scale demolition and remodelling of estates such as Aylesbury.

The response also considers the changes to the Housing Revenue Account, borrowing opportunities and ways in which the council could lever in additional resources.

On the effectiveness of the Government's Affordable Rent proposals, the response outlines the key areas of concern:

- The affordability of the product taking into account the income levels of Southwark residents.
- The effect of regeneration programmes, including the impact of decanting and community sustainability.
- The effect of the proposed welfare benefit changes.
- The affect of the introduction of fixed term tenancies on perceived security of tenure, and the impact on tenancy acceptance rates.

Q1. *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

It is important that return on investment is considered in a qualitative way in output terms. Obviously, the number of units delivered overall is key, but issues of design quality, bedsize, affordability, sustainability etc are also central to the success of developments.

We welcome the introduction of New Homes Bonus as an additional source of funding for new homes, although it is important to highlight that there are potentially other high priority services/commitments which could benefit from this funding source to meet a range of community needs. Therefore the development of other funding opportunities is still needed to assist Southwark to address the major regeneration aims often arising from the quality and condition of the existing council housing stock. On the positive side, these provide opportunities to develop new housing and create more mixed and balanced communities and lever in private sector investment on a scale unique to Southwark in the light of its landholding.

As outlined in the introduction, for schemes such as the Aylesbury regeneration, to allow the council to realise the value of land to generate resources, a key challenge is funding the necessary site assembly (decanting, leaseholder buybacks and demolishing large scale blocks) and developing new infrastructure. Consequently, we would suggest that the grant regime has to be flexible and responsive to allow for the provision of up-front funding for regeneration, with the understanding that in the long term the need for public funding will be reduced and allow for the private finance cross subsidy to be maximised.

## Regeneration

We recommend the use of innovative and flexible approaches as adopted in previous and ongoing major regeneration projects in Southwark. The key elements have been working pro-actively with developments partners—both Registered Providers (RPs) and private developers, to unlock the value in the council's own land thereby levering in both private and public finance. In addition, the council's excellent working relationship with the Homes and Communities Agency has enabled substantial resources to be attracted to the borough, and development outputs to be maximised. However we recognise that in the current economic climate these possibilities will become increasingly challenging.

Two excellent examples of partnership working to deliver major regeneration are the council's major projects at Canada Water and Bermondsey Spa.

*Bermondsey Spa SE1*: This scheme combines new primarily residential developments on both private and public sites with investment in the existing housing stock. The overall aim being to rebalance the local community, to provide diversity and a greater mixture of housing types. S106 resources have been used to enhance local facilities and the public realm to complement the regeneration, and investment from the Homes and Communities Agency (HCA) has assisted in delivering increased levels of affordable. In net terms, the levels of affordable homes have significantly increased, with approximately three times more affordable housing gained than lost.

*Canada Water SE16*: With the particular challenges faced in this area and with the resources available to the council, it was decided that a strategic development partner would be sought through an EU procurement process. British Land Canada Quays (BLCQ) was selected and signed a strategic ten-year development agreement with the council in 2005. This was done with a view to creating a vision, by way of a master plan, for the core area near the transport nodes of Canada Water and Surrey Quays stations.

Parallel work has included extensive on-going public engagement and specific relationship building with the key strategic land owners in and around the area. There are relatively few land owners in control of around 60 acres of land, with some recent changes of ownership of major land holdings.

As the first phase of the development in Canada Water is coming to an end, there are opportunities to proactively use council's land holdings to drive further regeneration of the area. British Land has recently entered into the joint venture ownership of the Surrey Quays shopping centre. The council owns the freehold of the site with the British Land Tesco partnership owning a long lease. The shopping centre is a key part of the next phase of development in the area, providing important infrastructure for residents. There are opportunities for expansion of the retail offer with around 30,000 ft2 new retail space, together with capacity for around 600 new homes within that expansion proposal.

In addition, to assisting with the viability of the regeneration, the council has also allocated funds from its Affordable Housing Fund (AHF), arising from in-lieu payments. The presumption throughout the council's Core Strategy is that affordable housing will be delivered on site as part of the development. The Affordable Housing SPD sets out the process which must be followed for the council to consider an in-lieu payment.

We have some more general suggestions to generate the best return on investment as follows.

### Mixed Delivery Approaches

The council is investing resources in unlocking important schemes, for example at Elmington Estate in Camberwell where a mixed scheme of redevelopment and investment to Decent Homes standard is being delivered, in the next phase of a longer term regeneration scheme. This mixed solution provides an important model to assist the balance between stimulating new development on the one hand and investment in Decent Homes and landlords' obligations in our own stock on the other. Neither a full refurbishment or a full redevelopment were viable; the mixed approach will ensure the delivery of the maximum amount of new housing.

*Effective partnerships*

We recognise that we cannot achieve these ambitions without partners. In addition to the partnership working with the HCA, Southwark also has a number of successful partnership groups and forums in operation. These include the Southwark Housing Strategic Partnership, which is a multi-agency partnership between the council, RPs, private sector developers, tenants, leaseholders, private sector landlords and residents. In addition the council works with the Southwark Housing Association Group which provides the primary interface with RP partners, and also the South East London Housing Partnership.

We have an active dialogue with the RPs that develop in the borough, meeting with each of them formally on a quarterly basis to review their delivery pipeline, to discuss new opportunities and address any issues impeding delivery. We also maintain a site register, which is regularly viewed to ensure potential development sites are being progressed.

### Review Clauses

Southwark was one of the first authorities to build reviews into S106 agreements, so that if end values in developments increase beyond an agreed baseline, there is scope to improve the affordable proportion. The council has also adopted the practice of granting short consent periods on smaller schemes where concessions are made on the affordable proportion, to encourage their early delivery. In all cases the review mechanisms permit only an upward revision of the affordable housing provision. Two examples of these clauses in use in Southwark are:

*Case study 1*

The principal feature of this scheme/mechanism is if the developer has not started particular phases by a particular time, it could not commence construction works unless it had submitted a viability review of that phase.

It was determined at the point of consent that 114 affordable dwellings would be provided (representing 28.3% of the development). Any extra on-site provision (for all phases) triggered by this mechanism would be a maximum of 95 habitable rooms (amounting to 6.7% of the development) which, added to the affordable provision that the developer is obliged to deliver, would represent the council's policy requirement that 35% of residential development is affordable.

*Case study 2*

A viability assessment at the point of consent determined an affordable housing provision of 25% (125 units). Similar to the scheme described above the developer would submit a viability scheme for each phase. Negotiation with the council would determine whether any extra affordable housing, up to a maximum of 10% is justified by the viability assessment. In the event that any extra provision amounted to less than 10 habitable rooms, the contribution would take the form of a payment-in-lieu.

Appropriate Planning Policy

Southwark's Local Development Framework helps enable high quality housing. As set out in the above sections, the council has been flexible where appropriate, to ensure housing continues to be delivered during the recession.

The Local Development Framework provides clear planning policy, based on a robust evidence base to ensure the delivery of more and better homes. Setting out clear up-to-date policies and guidance means that the council are clear and transparent in what we expect from new development, and where we expect new development to be located. The adopted Core Strategy sets out policies on density, housing targets, affordable housing, student housing and gypsies and travellers. A housing implementation strategy was developed as part of the Core Strategy, looking at sites and timescales where housing could come forward. The Core Strategy introduced a new policy requiring an element of student housing to be affordable housing, which will help meet Southwark's need for more affordable homes. The Council has also prepared/is in the process of preparing a number of area action plans and area based supplementary planning documents. These provide more detailed policies and guidance for specific areas including Canada Water, Elephant and Castle, and Peckham and Nunhead.

The council also has two housing supplementary planning documents on affordable housing and residential design standards. These set out detailed guidance on how to ensure the maximum amount of affordable housing and good quality new homes.

Q2. *What is the role of state lending or investment, as opposed to grant funding, and the appropriate balance between them?*

Borrowing is useful as part-funding for the building costs of rented stock, up to the debt level where repayment and interest can be met from the surplus of rent over running costs. Future rental levels are relatively risk free but local authorities can only borrow within HRA self-financing debt caps.

Borrowing or investment for stock for sale introduces significant risks in terms of future market values. State lending via PWLB is easier to access and usually more flexible than bank/bond borrowing but at current rates may be more expensive.

Affordable housing cannot usually support borrowing of the full capital cost and grant or other funding is also required.

For local authorities, grant via HCA eg for new build is useful but it would be simpler if deadlines were loosened and there was increased flexibility—there is pressure to start on site perhaps before all risks are analysed and a lot of interchange is generated over minor changes to completion dates. It would also help if annual grant programmes were established so that site assembly could commence with some prospect of funding for eventual new builds for example by the use of pre-allocations. In addition, the requirement to charge Affordable Rents to attract social housing grant causes concern, as outlined in the response to question 7.

Grant levels per dwelling have been reduced through changing the outputs to affordable rented homes but LAs may still wish to prioritise the provision of social rented homes. Market rented developments might provide cross-subsidy and hence reduce grant need for LA or RP social rented schemes but may be difficult to balance whilst meeting affordable targets for each site.

Q3. *What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening*

Some examples of the LA role in funding support can be provided by experience in Southwark. Due to the scale and nature of the council's own housing stock, the potential resources derived from the sale of assets provides a key source of funding to reinvest in the housing stock. The council is planning to invest a minimum of £326m over the next five years, with an element of this funding projected to be resourced from disposal proceeds. Therefore, the ability to explore options for disposing of land at less than best consideration is reduced.

Therefore, it has proved challenging to explore such as Community Land Trusts, where the presumption is that land will either be provided free or at a considerable discount.

However, the Council has been flexible in recent years during the economic downturn, especially in order to keep regeneration projects moving forward, for example at the Elephant & Castle.

To enable the development of housing sites on the council land in partnership with RP partners, as part of the regeneration of the Elephant & Castle, the council agreed to forgo land receipts to advance the wider objectives of the programme. This decision, along with investment from the HCA and a flexible approach to tenure, switching private units to affordable ensured that the schemes were delivered, enabling commitments made to existing residents to be met.

Other examples of the council's flexibility in using its own land to enable development in the economic downturn have included:

- — Allowing for phased payments, structuring payments as opposed to requiring full payment on purchase of the site.
- — Overage or underage arrangements.
- — Agreeing to land disposal on a subject to planning basis rather than unconditional.

Q4. *How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

Pension funds are showing interest in investing in social rented homes, where their return could be linked to RPI. This could be in the form of bond lending. Local authorities have caps on borrowing and may not be sure enough of marginal income increases to enter into arrangements that involve RPI increases each year; however these deals could offer lower initial debt charges in the early years of self-financing, when finances are tight.

A charge on new property might be offered as security for private finance providers but there may be a conflict between enabling potential handover of a liquidisable asset and security of tenure for social housing tenants.

Other barriers are around perceptions of risk and strategic fit within portfolios of lending and business activity.

Taking these issues into account we would suggest that the development by the government of a national framework to support institutional investment, therefore allowing for volume and packaging to maximise the risk/reward ratio could help overcome the existing barriers.

Q5. *How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

We have discussed this question with our RP partners and two key issues have been highlighted:

- — Increasing grant as it leverages in more private finance by helping with RP gearing.
- — Work with lending institutions to agree to amend existing RP covenants so that borrowing is based not on the lowest gearing ratio, but the highest.

Also, we have concerns that the model is not sustainable in the long term. For example, the benefits of converting current stock to affordable rent can only be realised once, and means the stock of social rented housing is continually reduced at a time of increasing demand. Furthermore, RP are having to reach the limits of their lending covenants and may not be able to secure further increased leverage for future funding rounds.

Q6. *How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply*

LAs expect to generate revenue surpluses in the medium and long term as they will keep the proceeds of real terms rent rises under HRA self-financing. Before that there is an early year's deficit to meet because the self-financing model allocates debt affordable from rents over 30 years and their initial level is well below the average for that period. Once LAs move into surplus there is the possibility of increasing investment, either by direct revenue contribution of available surpluses each year or by Prudential borrowing (subject to the self-financing debt caps), with the surpluses paying the debt charges incurred. Investment in new-build may be favoured as replacement for older stock or as extra stock but this will depend on land availability.

The caps on HRA debt may inhibit the level of new build, as will the starting level of interest on 2012 debt, which will vary between authorities. The PWLB recently announced a reduced interest rate for authorities taking on extra debt (at historically low rates). It would have been helpful to see similar relief for those carrying over existing debt at high rates.

In the short-term, local authorities may start in 2012 with substantial commitments that are short of funding, eg decent homes backlog and fire safety works, and these may use resources that would otherwise go towards new-build.

In general, more flexibility on how authorities spend HRA receipts and deal with debt redemption would be desirable.

Q7. *How effective the Government's "Affordable Rent" proposals are likely to be*

The council is committed to enabling the delivery of truly affordable housing throughout the borough, in line with the aims and objectives of the newly adopted Core Strategy. The council is not supportive of the rent and tenure implications of the new Framework, which we feel run counter to the demonstrable needs of our community. That said, we consider that enabling some development is preferable to ceasing altogether; we therefore encouraged the submission of offers from RPs to the HCA for funding from the 2011–15 Affordable

Housing Programme to continue the delivery of new affordable housing in Southwark. It was emphasised that RPs should tailor the offers to enable the delivery of schemes which address the housing needs, affordability and regeneration priorities of the borough. In addition, RPs were advised to give particular consideration as to how offers, including for "Affordable Rent", would address the issue of affordability, taking into account that the Housing Requirements study 2008 for Southwark found that the median income for council tenants is £9,100 pa and for HA tenants £14,300. Southwark has challenging targets to meet to deliver affordable housing; therefore, having an active development pipeline is crucial.

RPs were encouraged to bring forward with proposals that addressed Southwark's objectives, including delivering larger homes, providing decant and option to return opportunities for residents in regeneration schemes, alleviating overcrowding and tackling under occupation.

Subsequently, we have carried out assessment of the impact of affordable assessing the income levels required based on the following factors:

- Income levels in the borough.
- Potential rent levels as varying percentages of market rent, across the borough.
- Impact of increases in Private Rent.
- The level of gross income spent of housing costs.
- Universal credit.

The study has backed up the initial view that there are affordability problems arising from the Affordable Rent model, even at less than 80% of market rent. This particularly affects family units ie 3 bed plus. For example, based on the current policy definition of affordability (25% gross income spent on housing costs), even at 60% of market rent would require an annual income of c33k (1 bed), 38k (2 bed), 49k (3 bed) and 66k (4 bed) in SE17, the location of the Aylesbury Estate.

Taking these findings into account, we are exploring the following options for development of an emerging strategy on Affordable Rents, and to inform our Affordable Housing SPD:

| | *1 bed* | *2 bed* | *3 bed* | *4 bed plus* |
|---|---|---|---|---|
| Option 1 | 80% | 80% | social | social |
| Option 2 | 80%* | 70%* | social | social |
| Option 3 | 80%* | 60%* | social | social |

* or capped at LHA rates.

A 4th option is also proposed for consideration:

For Section 106 schemes with no grant, developers to be asked how much housing at social rent they can provide, in return for waiving the 35% affordable contribution if necessary.

The council has commissioned an independent review on the viability of these options.

We would add that in the framework for the Affordable Rent programme, the opportunity was missed to cap the rent levels at Local Housing Allowances levels. This has already been the cause of concern in that RPs have suggested rents above LHA levels.

In addition, there are concerns about the long term sustainability of the Affordable Rent programme, in that conversion of relets can only unlock resources on a once and for all basis, as noted in response to Question 5.

The introduction of flexible tenancies in conjunction with Affordable Rent also provides concern, in particular that short term tenancies will provide a barrier to movement in the social sector. For example, residents being decanted to enable regeneration are likely to resist giving up a secure tenancy, for one of only five years and at rent levels far in excess of what they currently are charged. This would have major implications for the delivery of regeneration projects, because delivering decant programmes are the key to effective development.

*October 2011*

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**Written submission from the Regenda Group**

It is clear that action needs to be taken to increase new housing supply as currently supply is not matching demand. Evidence would show that rates of new build housing have been on a downward trajectory. Also the restriction in government funding to support the affordable housing programme is a factor that contributes to the generation of new housing supply particularly in the affordable housing sector.

We welcome this inquiry and are pleased to contribute. Our submission focuses on three areas which are particularly pertinent to the affordable housing sector:

- Affordable Rent proposals.

- Increasing the amount of private finance into new housing supply in the affordable housing sector and new forms of investment.
- Access to home ownership.

### Affordable Rent Proposals

It is our view that the Affordable Rent proposals will only play a role in increasing the funding available for new supply over a limited period ie 2011 to 2015. The proposals effectively mean that the providers of affordable housing will have to meet an increased proportion of the cost of the new housing supply that they develop. Providers will have to use private finance to bridge the gap of the reduced amounts of grant available for funding affordable housing and it is doubtful whether this is sustainable across the sector beyond 2015. It is therefore important that consideration is given to levels of capital and revenue subsidy and also increasing the amount of investment in new affordable housing supply from the private sector.

*Increasing the amount of private finance into new housing supply and new forms of investment*

It is apparent that traditional sources of lending to the affordable housing sector have become restricted clearly linked to global and national economic issues despite the sector having a long history as a low risk investment proposition.

There is obviously a need for a larger scale of long term investment into the sector. Potential options include bond finance, lease backed funds, investment by sovereign wealth and developer led lease arrangements.

In terms of attracting investment into the sector we would welcome action by the government to support the low risk perception of the affordable housing sector. In particular we are concerned that the welfare benefit reforms may have an impact on the perception of the sector and the sound investment proposition that it has been viewed as historically.

Another area which could positively benefit investment in the affordable housing sector is the write off of historical social housing grant. Under current rules, landlords cannot borrow against social housing grant held on their balance sheets because the government could under certain circumstances ask for it to be returned. Consideration should be given to the write off of this historic grant which would enable Registered Providers potentially to borrow against the value of this grant and potentially contribute to the funding of new affordable housing supply.

### Access to Home Ownership

We understand that unlocking the stagnant housing market is an important issue; however as a provider of low cost home ownership products ie shared ownership/shared equity we are aware of the negative impact of constricted mortgage availability in restricting access to home ownership. This is exacerbated by the restrictions attached to available mortgage products.

We would ask the government to consider how it could work with lenders to return to a balanced view of lending. One potential area is an offer by the government to guarantee to bridge the gap between 90% and 95% mortgages. Albeit we accept some risk in these proposals consider that it warrants further analysis. Another option is to look at how the government could support public bodies in providing mortgage products. There are examples of highly successful local authority mortgage schemes which have seen high levels of demand which we would also suggest warrant further consideration in terms of government support.

Increasing the availability of mortgage finance is critically linked to the issue of housing supply as building rates will only increase if there is confidence that sales will take place post completion.

In this section we have focused on access to home ownership as it remains the case that many people aspire to home ownership; however it is important that there are options available in terms of good quality affordable rented accommodation. It is therefore imperative that there is an appropriate level of investment in rented models and would request that this is kept under review as part of a wider package of housing offers.

*October 2011*

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## Written submission from the Highbury Group on Housing Delivery

### Summary

The affordable rent programme is not sustainable in the longer term, as homes provided under the programme will not be affordable in many areas of the country and moreover are unsustainable for many providers in terms of their financing assumptions and business plans. Initial modelling of the potential outcome of the new and proposed funding regimes—the termination of direct funding for social rented homes, the new affordable rent programme, the increased rent income generated by the affordable rent programme (including conversions of existing social rented stock), use of the New Homes Bonus and the introduction of self financing Housing Revenue Accounts, demonstrates that the potential affordable housing output will be substantially lower than

both past output and assessed requirements. This position will be worsened by any extension of Right to Buy discounts or eligibility, for example sales to households on waiting lists.

Any Government has to recognise that for housing to be affordable to lower income households, and in high value areas to most middle income households, some form of subsidy, whether through direct grant and/or land subsidy is essential. For social rented homes, subsidy should meet the cost of development less the debt supported by the long term rental stream based on target rents. One option is to introduce a funding mechanism similar to the previous total cost indicator (TCI) based grant regime which was the basis of the highly successful and cost effective mixed funding regime which operated through most of the late 1980s and 1990s. This would need to ensure that cost assumptions and grant rates were kept up to date to reflect both local variations and market changes to avoid cost over value provision. A funding regime for affordable housing which is dependent on using up a low cost landbank, using rent increases on existing stock from a limited flow of relets and receipts and planning obligations from a volatile housing and property market is by definition unsound and unsustainable.

### 1. Introduction

The Highbury Group comprises an independent group of specialists from public, private and independent sectors with a membership drawn from housing, planning and related professions; it offers advice and makes representations to Government and other agencies on a variety of subjects, including responses to the recession, with the aim of maintaining and increasing the output of housing, including high quality affordable housing (see footnote for membership and objectives).

### 2. Responses to Questions

*How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms*

2.1 Capital subsidy should be focused on the provision of social rented (rather than merely "affordable") housing at or below target rents in the areas of greatest unmet housing need. It is most cost effective in the longer term for the public sector to invest in social housing, owned by local authorities and registered providers, which will continue to be available in perpetuity to both households who are currently in housing need and households who in the future will be unable to access market housing. It should be stressed that the provision of new social housing constitutes both public investment and a revenue saving to the public purse. It is a public investment because the asset value of housing appreciates and provides security for future public and voluntary sector borrowing.

2.2 Provision of bricks and mortar subsidy generates a revenue saving in a number of ways:

- it reduces dependence on revenue support through housing benefit and the Local Housing Allowance;
- consequently it reduces the disincentive to a household to obtain employment (ie the provision of higher subsidy and lower rent prevents the poverty trap);
- provision of good quality affordable housing with secure (ie not time-limited) tenancies inhibits involuntary mobility and consequently diminishes education, health and criminal justice costs; and
- provision of new affordable homes also avoids the costs to the public purse of housing homeless households in bed and breakfast accommodation, hostels, or privately leased temporary accommodation.

2.3 Investment in the provision of new housing is also to wider economic policy objectives in that construction generates significant increases in employment (and consequential reductions in benefit expenditure) and that new homes and residents will increase local consumption and local jobs in retail and related sectors.

2.4 Use of public funds to support home ownership does not help households in the greatest housing need and provides a limited long-term return for public policy objectives, and no such return where households staircase to outright home ownership. Such financial support when provided to households to access homes in the existing market can exacerbate house-price inflation and consequently reduce affordability for households not benefitting from this funding. Shared ownership funding should be conditional on repayment of subsidy from increased value of onward disposal. At a time of resource constraints, it is important that an assessment is undertaken of both the long-term costs and benefits to both the public purse and to residential occupants of different levels of capital and revenue subsidy for different forms of tenure.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

2.5 Where state funding is provided either directly or indirectly (for example through subsidised land disposal) to private sector bodies or local land trust or local housing trust, then investment should be in the form of an equity stake, where the public sector, normally in the form of a local authority, receives a return from value appreciating, which can reinvested in the provision of affordable housing or related infrastructure. It is rare for housing associations to borrow from the Public Works Loan Board. This is partly because the

PWLB rate is little different from the cost of borrowing from the money market (the current PWLB rate is 4.00% for 30 year fixed plus 100 basis points, making 5.00%, whereas HA new debt is priced at 3.56% (gilt equivalent) plus 150 basis points, making 5.06%.

*What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening*

2.6 Local authorities should provide social rented housing on land in their ownership. This is allowed by existing consent arrangements. The value of land is translated is translated into the benefits of nomination rights to good quality accommodation at low rents. It is also justified in value for money terms by the long term savings arising from fewer households being placed in temporary accommodation and the savings to the costs of public service provision arising from fewer households being in insecure and/or substandard accommodation. Where local authorities provided subsidised land for development by registered providers, this should be in exchange for nomination rights to social rented and shared ownership homes, a right to buy back at a discount shared ownership homes and an equity stake in market development. The value of the benefit provided should be costed and be no more than the discount in land value. The main barrier to such approaches is the need for local authorities to maximise disposal receipts to fund other services or investment projects.

*How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening*

2.7 There are circumstances in which the return to private investors in relation to provision of new housing or regeneration of existing residential areas are insufficient to generate sufficient investment. This is especially the case in areas where values are low and where site preparation and infrastructure costs are high. It is critical that more longer term investment is brought into the funding of residential development, where there is certainty of incomer stream, especially where asset appreciation is less guaranteed. Tax incentives to developers to provide affordable housing rather than open market housing could be considered.

2.8 There are strong indications that some registered providers are experiencing increasing difficulty in obtaining sufficient private finance at affordable interest rates to support their development programmes, as shown for example by the recent TSA quarterly survey of housing associations (September 2011). The new affordable rent programme is especially problematic, in that registered providers have to obtain much higher levels of private finance, given the lower level of grant available relative to historic grant funding for social rented housing. The Government's proposals in the Welfare Reform Bill are likely to lead to lenders being increasingly concerned as the level of security for their investment in terms of the lack of a guaranteed revenue stream from which the interest and debt can be repaid. In particular proposals to restrict local housing allowance and housing benefit payments for both private and "affordable rented" tenants and proposals to terminate direct payments to landlords increase the level of risk and uncertainty associated with housing provision. The proposal for a new universal credit exacerbates this uncertainty about continued provision of assistance to lower income groups.

The shortage of funding in transport, social, utilities and green infrastructure is also an obstacle to private sector investment, especially where the development of a substantial new residential community is envisaged. Part of the delays to current development programmes reflects uncertainty as to the timing of funding for infrastructure to support new schemes. Certainty of public funding is needed for a developer to be able to have some certainty as to sales values and build out timescale.

*How registered providers and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply*

2.9 Some registered providers and ALMOS with stock in their ownership, will have an asset base against which they can borrow. Such borrowing will need to finance both re-investment in their existing stock as well as new investment. However this capacity will not necessarily be concentrated in areas of the country in which there is greatest need for new affordable housing provision. There is a case for some pooling arrangement to ensure that surpluses are used to support new investment for appropriate housing in suitable locations where need has been clearly established. There is also a case for introducing a mechanism for sharing underutilised capacity (surpluses/low debt) in smaller non-developing housing associations.

*How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply*

2.10 The move towards HRA self financing is broadly welcomed. However the use of asset valuation as the basis of subsidy and clawback, which is the starting point for the new regime does not reflect the differential need for and cost of providing new affordable housing within different local authority areas. Moreover the mechanism does not deal with the fact that many Local Authorities have disposed of their housing stock and consequently have no HRA to be rebalanced. Some of the authorities with the largest stock holdings, such as Birmingham and Southwark, do not necessarily benefit from the new regime. In some areas where there is still a significant shortage of social housing, local authorities' ability to invest in new provision will in fact be reduced rather than enhanced by the proposed change.

*How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term*

2.11 In some parts of the country the "affordable rent" programme does not provide a viable mechanism for new affordable housing, In areas where market rents are low and social rents only marginally below market levels, the rental adjustment will not increase registered provider income and consequently will not affect their ability to fund new homes. In higher value areas, rents at 80% market rent can be twice or more the level of existing target rents and will therefore generate significant problems in term of benefit dependency and the poverty trap. Affordable rented homes where rents and service charges are at levels above 30% net lower quartile incomes should not be treated as affordable housing (and in the London case are in breach of the definition of affordable housing in the London Plan). There is concern that the requirement for registered providers seeking funding for affordable rent provision to convert existing social rented homes to "affordable rent" on termination of tenancy will lead to a further reduction of social rented housing supply in areas where shortages are most acute. The Government's assumptions as to the level of new housing which could be funded from higher rents, including those from converted stock, appear highly optimistic. They are not an adequate basis for the Government estimate that 250,000 homes can be funded from this new regime and that direct grant will not be required as from 2015.

3. Other Issues

*The New Homes Bonus*

3.1 The New Homes Bonus is welcomed, but its distribution does not bear any relation to where the need for affordable housing is spatially located, or the location of future development capacity. The use of new homes bonus is not ring-fenced to ensure either new housing provision or the funding of infrastructure to support new communities, and therefore the positive role of the bonus is incentivising additional output is likely to be limited. Moreover by failing to distinguish between different types of "affordable housing" the bonus acts as an incentive to provide low subsidy higher rent sub-market housing ( at a cost to the housing benefit budget) rather than low rent social rented homes. Not all local authorities in areas of greatest housing need regard the NHB as sufficient incentive to persuade them to support new housing provision, to which they have previously been opposed. The NHB is a useful supplement to a target based system but not a substitute for it.

*Impact of enhanced Right to Buy*

3.2 The group is also concerned that introducing increased discounts for Right to Buy will decrease the supply of social rented provision and counter the impact of any new investment in additional affordable homes. The higher the level of discount, the greater the net loss of social housing stock and the lower the level of replacement fundable by receipts. Experience has demonstrated that better quality family size street properties have the highest disposal rate. Any retention of Right to buy should be predicated on one for one replacement in qualitative as well as quantitative terms: ie the receipt from the sale of a low rent social 3 bedroom house in inner London should be sufficient to fund the provision of a replacement low rent social 3 bedroom house in central London. These replacement units should be provided at target rents. All receipts from the disposal of council homes should be reinvested in additional housing provision. Additional grant will be needed to ensure a like for like replacement. Further extension of the Right to Buy should not be implemented before a full equality impact assessment has been carried out.

4. Conclusion

4.1 The affordable rent programme is not sustainable in the longer term, as homes provided under the programme will not be affordable in many areas of the country and moreover are unsustainable for many providers in terms of their financing assumptions and business plans. Initial modelling of the potential outcome of the new and proposed funding regimes—the termination of direct funding for social rented homes, the new affordable rent programme, the increased rent income generated by the affordable rent programme (including conversions of existing social rented stock), use of the New Homes Bonus and the introduction of self financing Housing Revenue Accounts, demonstrates that the potential affordable housing output will be substantially lower than both past output and assessed requirements. This position will be worsened by any extension of Right to Buy discounts or eligibility, for example sales to households on waiting lists.

4.2 Any Government has to recognise that for housing to be affordable to lower income households, and in high value areas to most middle income households, some form of subsidy, whether through direct grant and/or land subsidy is essential. For social rented homes, subsidy should meet the cost of development less the debt supported by the long term rental stream based on target rents. One option is to introduce a funding mechanism similar to the previous total cost indicator (TCI) based grant regime which was the basis of the highly successful and cost effective mixed funding regime which operated through most of the late 1980s and 1990s. This would need to ensure that cost assumptions and grant rates were kept up to date to reflect both local variations and market changes to avoid cost over value provision. A funding regime for affordable housing which is dependent on using up a low cost landbank, using rent increases on existing stock from a limited flow of relets and receipts and planning obligations from a volatile housing and property market is by definition unsound and unsustainable.

*Footnote*

The Highbury Group is an independent group of specialists from public, private and independent sectors from housing, planning and related professions which prepares proposals for Government and other agencies on responses to the current "credit crunch" aimed at maintaining the output of housing including affordable housing.

The group was established in 2008 as the Highbury Group on housing and the credit crunch and originally met at London Metropolitan University in Highbury Grove, Islington, London (thus the name). The group's name was changed in September 2010 and it now meets at the University of Westminster, 35 Marylebone Road, London NW1. It comprises the following core members: Duncan Bowie—University of Westminster (convener); Stephen Ashworth—SRN Denton; Julia Atkins—London Metropolitan University; Bob Colenutt—Northampton Institute for Urban Affairs; Kathleen Dunmore—Three Dragons; Michael Edwards—Bartlett School of Planning, UCL; Deborah Garvie—SHELTER; Stephen Hill—C20 Futureplanners; Roy Hind—Bedfordshire Pilgrims HA; Angela Housham—Consultant; Andy von Bradsky—PRP; Seema Manchanda—L B Wandsworth; Kelvin McDonald—Consultant; Tony Manzi—University of Westminster; James Stevens—HomeBuilders Federation; Peter Studdert—Planning consultant; Janet Sutherland—JTP Cities; Paul Watt—Birkbeck College; Nicholas Falk—URBED; Catriona Riddell—Planning Officers Society; Alison Bailey—consultant; Richard Donnell—Hometrack; Pete Redman—Housing Futures; Richard Simmons.

The views and recommendations of the Highbury Group as set out in this and other papers are ones reached collectively through debate and reflect the balance of member views. They do not necessarily represent those of individual members or of their employer organisations.

The key purpose of the group is to promote policies and delivery mechanisms, which:

- increase the overall supply of housing in line with need;
- ensure that the supply of both existing and new housing in all tenures is of good quality and affordable by households on middle and lower incomes;
- support the most effective use of both existing stock and new supply; and
- ensure that housing is properly supported by accessible infrastructure, facilities and employment opportunities.

*October 2011*

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## Written submission from Professors Tony Crook and Peter Kemp

### Executive Summary

- The ownership of the private rented sector remains dominated by small scale individual landlords.
- Government attempts to attract institutional funding have not yet been successful and substantial barriers to attracting it remain in place.
- The current economic and housing market climate increases the prospects of achieving more institutional investment but changes to the tax arrangements are needed to overcome the remaining barriers.

### Introduction: Background to our Submission

The Committee asks how long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening. Our submission is focused on the question of whether financial institutions are likely to invest in private rented housing.

The basis for our response is the evidence we have gathered over the last three decades on the transformation of private landlords in England, including since rent deregulation and specifically on the impact of attempts to create a more "modern" form of landlordism and to attract financial institutions to invest in the sector. In relation to the latter we have monitored and evaluated two government initiatives to attract more corporate landlords and institutional funding: the Business Expansion Scheme (BES) and the Housing Investment Trust (HITs) scheme. We have also examined the attempts to create residential REITs. Our work has been widely disseminated and we have been regularly involved in policy briefings and discussions. Our most recent joint publication brings much of this work together[18] and it is on this evidence base that we are submitting our memorandum.

*The rationale and impact of government initiatives to attract financial institutions to the private rented sector*

Throughout the developed world, the supply of private rented dwellings is largely a "cottage industry". The British experience is thus part of a global phenomenon. A very large proportion of the sector in Britain is owned by private individuals, each with small portfolios with many managed and maintained in their landlords' own spare time and not by managing agents. There are very few large residential property companies. Moreover, only a small proportion of the dwellings in the sector are owned or managed by those with relevant

[18] Crook, Tony & Kemp, Peter A (2010), *Transforming Private Landlords*, Oxford, Wiley Blackwell.

professional qualifications or belonging to trade and similar organisations which require their members to comply with specific standards and codes of conduct when managing property.

Over the last three decades, Governments in Britain have been keen to see an increase in company ownership and institutional investment. This, they hoped, would secure long term investment, reinforce the sector's improving reputation, achieve economies of scale and spread risk better than small scale individuals, foster longer term tenancies since institutions seek a long, not short term, presence in the market, bring newly built properties into the sector, and "smart" make regulation easier and more effective.

To achieve these objectives, governments have pursued a range of initiatives to encourage new investment by companies and by financial institutions. However, instead of designing these with the specific needs of private renting in mind, governments (i) adapted existing schemes designed for other purposes and (ii) did not address the fundamental barriers preventing the emergence of larger companies and institutional investment.

Thus although the Business Expansion Scheme (BES)—which was extended to private renting between 1988 and 1993 and designed to "kick start" new individual investment in shares in new private renting companies—initially resulted in 900 being created and 80,000 dwellings coming into the sector, it had only a short-term effect. This was partly because the returns being earned were not competitive. It was also because the BES tax incentives encouraged short term investment. Few of the BES companies lasted beyond a few years, with many of their dwellings being sold off and moving into other tenures when the companies were disbanded.

The subsequent initiative, to create Housing Investment Trusts (HITs) in 1996 did not succeed in creating a single one. It was designed to overcome some of the taxation barriers to institutional investment in private renting by creating tax transparency. Financial institutions were at that time not keen to be the direct owners of private rented dwellings but if pension and other gross funds instead invested indirectly through a property company or other vehicle they would suffer a tax loss compared with direct ownership. HITs only partially addressed this problem since they would have paid only a lower rate of corporation tax and no capital gains tax. But despite many efforts to launch HITs none succeeded. Returns were not competitive (despite the tax arrangements), it was hard for putative HITs to find the dwelling stock they needed for the minimum scale of investment required, housing management services were hard to find and complex rules within the HITs structure and stock exchange listing rules made it difficult to get one underway.

The subsequent Real Estate Investment Trust (REIT) initiative (from 2007 onwards) created the possibility of fully tax transparent residential REITs, notionally able to attract pension and life funds to invest without a tax loss for them. However, to date this has not resulted in even one residential REIT being established, although the great majority of commercial property companies have now converted to REIT status. This is partly because, despite the initial impetus to forming REITs being based on the desire to get institutional funds into the private rented sector, the initiative became transformed into one addressing investment in all property not just in private residential property. Thus the rules were designed to ensure, inter alia that such conversions did not come at the price of a big tax loss for the UK government. Moreover the Homes and Communities Agency's Private Rented Sector Initiative (PRSI) does not appear to have overcome the remaining barriers to institutional investment (which we discuss in the next section) despite the incentives the HCA offered potential investors

What has happened instead of the hoped for injection of institutional investment and the formation of new residential property companies is that the proportion of the sector owned by individuals with small portfolios has grown. The "buy to let" phenomenon has dominated new investment and, until the current economic crisis, growing numbers of individuals have entered the sector seeking capital gains, not long term rental income returns, managing small portfolios in their own spare time and raising debt funding on competitive terms (in contrast to the period before rent deregulation when debt funding for private landlords was hard to find and expensive). Some new companies have been established but in the form of limited partnerships or property unit trusts with limited shareholder liquidity (often registered off shore for tax purposes) and serving niche markets, for example student housing (the latter involving companies such as Unite and Opal).

## Current Barriers to Institutional Investment in the Private Rented Sector

Our research evidence suggests that the barriers to attracting and retaining long term institutional investment into the private rented sector today are threefold:

First, the stock required to match institutions' needs, both in terms of "lot size" and quality (sizeable tranches of good quality newly built stock in desirable locations with good quality local management)s initiative and has been hard to find for those considering setting up funds—and the search for it takes much time (although the current depressed state of the housing market may generate opportunities for deals with house-builders).

Second, current income returns (ie net rents as a percentage of vacant possession capital values) are not attractive to potential equity funders. This is partly because rents are set in a market where the supply side of the sector is dominated by small scale individual landlords putting in their own spare time to manage portfolios and looking primarily for capital gains and not income returns. Whilst the house price boom up to 2007 delivered substantial total returns it did not produce the income returns desired by institutions (income returns fell as capital values rose), not the least given the potential novelty of this asset class.

Third, whilst the REIT legislation has removed one of the taxation impediments to attracting institutional funding by fostering tax transparency (important because gross funds do not wish to own residential property directly) other tax impediments remain, including the burden of stamp duty land tax on bulk purchases, VAT payments to property managers, and some of the REIT rules that act as a barrier to establishing, nurturing, and "growing" new residential REITs. The SDLT barrier has now been addressed in Budget 2011 but VAT remains a problem as, unlike commercial property, residential lettings require active and costly management. Some of the REIT rules also remain problems but these would be helpfully addressed if the proposed measures in the recent Treasury consultation are enacted.[19]

As a result there has not (yet) been the scale of investment that governments have been seeking, except in niche markets (like student housing with good covenants, often backed by universities), and through trusts, including with offshore tax arrangements, but with limited investor liquidity.

### Current Prospects for Attracting Institutional Investment

Our submission is based on our assessment of the extent to which the barriers we have identified can be overcome. We do not expect institutional investment to ever be a substantial part of the private rented sector (and nor is it in most other advanced economies) but it could play a useful role in attracting more long term investment. Residential lettings should in principle be attractive to institutions. Over the long-run, like house prices, market rents rise in line with earnings, thereby matching the liabilities of many potential investors. Demand for private renting is likely to rise rather than fall and many house-builders will be looking for new outlets now that the first time buyer market has become difficult and many housing associations are likely to commission or purchase fewer new dwellings under the new subsidy arrangements. And with stable or even falling nominal house prices and increasing rents there is every prospect of income returns rising (in contrast to the period during the "buy to let" boom). It would thus be, in our view, a propitious moment to remove the residual barriers to institutional investment, subject to value for money.

One of the key findings of our work on HITs and REITs is that the legislation gave very little recognition to the need to nurture new companies during their birth and incubation period as it takes time to build up a good portfolio (to find and purchase good performing property etc etc.) and convince potential investors of the returns. One of the key factors behind the failure of any HIT to be formed was the way the rules surrounding it prevented this incubation. So too do the current REIT rules. Unless these are changed our evidence suggests that significant barriers to forming new residential property companies under the REIT rules will remain in place

We would thus recommend:

(1) *Changing the diverse ownership rule* This would make it possible to launch of a residential REIT with a limited number of founding shareholders eg pension and life funds. It will enable them to establish a REIT, to prove its success and then draw in more shareholders. This is crucial in our view to getting residential REITs off the ground.

(2) *Allowing a fixed grace period for REITs to meet non close company requirements*. As we have already observed, it takes time to establish a fully fledged residential property company. We think it would take up to five years to acquire well working and profitable portfolios. At that stage such REITs would be in a position to draw in other shareholders who at that stage will not see (as they would at "launch") a novel and untested proposition. This is a crucial step to setting up "incubator" REITs.

(3) *Relaxing Stock Exchange listing requirements*. These rules were a major barrier to getting HITs established, not the least because the listing rules imposed meant that any HIT would have had difficulty in getting itself established. In our view, we need to nurture new small REITs which can then grow and eventually be listed. If new REITs can avoid complying with the limitations arising from listing and its administration costs, they can concentrate on acquiring and managing a profitable portfolio and making attractive investment returns, then seek a listing.

(4) *Abolish conversion charges*. The conversion charge was a sensible arrangement in relation to the conversion of commercial property companies but not for nascent residential REITs. In any case, there is really only one large scale residential property company in Britain and this has a trading, not an investment, model. If this requirement was waived for residential REITs it would encourage both the (i) new entrants that are needed and (ii) off-shore residential funds to return to the UK and contribute to its tax base. New residential REITs could also scale up by acquiring the (admittedly) small number of residential property companies without the charge inhibiting them from achieving scale economies (needed to get their housing management costs down). It might also allow banks to offload repossessed property held in separate vehicles, again which could be helpful in achieving scale for new REITs.

(5) *Cash should be permitted for an initial period of years as a good asset for the REIT balance sheet test*. It takes time to acquire a working portfolio and the inability to hold cash for a period whilst portfolios were built up was a major inhibitor in the establishment of HITs. Hence this amendment would allow REITs to judiciously assemble a good portfolio without being forced to spend it quickly

[19] Her Majesty's Treasury (2011) *"Informal consultation on REITs"* London, HM Treasury.

(and less judiciously) in order to ensure their balance sheet was comprised largely of physical and not financial assets. After the "incubation" period the current limit could be re-imposed, case by case.

(6) *Change the tax arrangements which treat the selling and buying of residential property as a trading and not as an investment activity.* This arrangement inhibits landlords operating as "normal" property companies. The latter are constantly adjusting their portfolios, disposing of properties that do not "perform" and replacing them with those that do. Taxing the gains from such disposals inhibits the development of well performing portfolios. It is important to encourage this portfolio adjustment behaviour for several reasons. First, it prevents the growth of some "mid range" landlords with 20 to 40 dwellings in their portfolios and low levels of gearing (unlike the new "buy to let" landlords of the "noughties" who are heavily geared) and who have on evidence an appetite to grow using their own equity. Second, because it prevents the growth of these companies it rules out the development of well run and performing medium sized companies whose acquisition could be the basis for the formation of the first REITs.

## Conclusions

So are there now any prospects at all of achieving the desired outcome? There are encouraging signs. On the tax front SDLT will only be levied on the average price of a dwelling in portfolio transactions. In addition the recent HM Treasury proposals to amend the detailed rules applying to new REITs should allow them time to get established before the full rules apply. And if they are allowed time to get underway the current state of the property market may at last make it possible for emerging REITs to find the stock they need. Builders are working in a difficult market: the first time buyer market is declining and housing associations face a more austere grants regime so their demand for new building may fall. Building to let privately in association with REITs would give house-builders a new outlet for their stock at a time when demand from first-time buyers is depressed and likely to remain so for some time. But although it is never likely to replace or even overtake supply by private individuals, if it comes to pass it will provide an important new ingredient to supply. If anything this is a more propitious time than any in the last three decades for the objective of stimulating institutional investment to be achieved.

In summary, our research and evaluation suggests that, while the 2011 Budget proposals on Stamp Duty Land Tax represent an important step towards making residential REITs an attractive proposition for financial institutions, additional amendments will be required if this important policy goal is to be achieved.

*October 2011*

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# Written submission from PlaceShapers

## About Us

We are a national group of 59 community based housing associations formed in 2008. We own more than 300,000 homes between us, provide services to more than one million people and employ over 70% of our staff locally. Together we completed over 21,000 new affordable homes in 2006–07—2009–10 and, as at May 2010, we had plans to invest around £2.7 billion to deliver a further 20,000 new homes.

We came together as a lobby group because we see the importance of working in depth with partners at a local level to achieve real improvements within an area. Good housing is the bedrock for a decent life and we are conscious of our pivotal role as change agents. Unemployment, crime, poor health, low educational achievement are all linked so what we do as housing organisations to help residents, local government and other agencies work together can make a huge difference to lives.

## Summary

There is a real opportunity to ensure that the nations housing needs can be addressed and the current economic challenge provides the catalyst to re-shape the market.

PlaceShapers believe there are a range of steps that can be undertaken which will improve the supply new affordable housing, if we:

- Establish a strong political vision with the aim of re-balancing the UK housing market.
- Reduce the size of the private sector land bank.
- Increase the supply of free/discounted public land.
- Adopt a shared risk approach and accelerate deferred land purchase arrangements.
- Ensure that any move to a purely revenue based grant model is deliverable regionally.
- Continue with the new affordable rent models it will increase capacity but on its own will not see a stepped increase in new supply, particularly in the Midlands and North.
- Increase private finance and availability.

## Context

Even in the good years, housing supply has been unable to meet demand. We now have 1.8 million households on English local authority housing registers. A recent survey (Savills) suggests that there will be a shortfall of 1.1 million properties within five years, and 1.7 million by 2029. The economic environment has significantly constrained new supply due to a combination of:

- weak housing market with poor prospects for real house price growth over the next five years;
- restricted access to land due to excessive land banking and unsustainable pricing;
- availability of corporate finance;
- weak job market which adversely impacts on confidence to enter into long term mortgage commitments;
- tighter lending criteria for mortgages and larger deposits (average deposit for first time buyer £26,500) even though interest rates remain at an all time low;
- reductions in capital grant funding for social housing;
- limited flexibility for social housing providers to cross subside new supply through mixed tenure;
- financial market volatility and shareholder confidence particularly for the volume house builders; and
- concerns regarding suitability and affordability of private rents.

The current economics suggest that the majority of first time buyers are unable to finance the requisite deposit, a position which is unlikely to change. The size of the deposit now required means that for 64% of the current non-homeowners the prospect of ownership is unrealistic (NCSE report).

For the first time in a decade, there has been a net movement out of owner occupation and into private renting, the numbers entering the rented sector rose by 21%. However the UK when compared to other larger European countries (England: 29%; France: 37%; Germany: 54%; Netherlands: 46%) has the lowest private and social rented markets. This reflects historical housing policies and the British mindset on owner occupation. This raises a real opportunity to reshape UK policy on renting as a sustainable alternative to home ownership, not just as a short term solution but a long term housing option.

The value of social housing stock rose by 75% to £247 billion in the last 10 years (Savills valuation). This is in contrast to the private rented sector which has seen increases of 178%. The marked difference reflects how social housing assets are driven by investment value of the income streams. This essentially takes capacity away from social housing providers. This position may improve as we move towards the affordable rent model.

The welfare reform programme has significant implications for new housing supply. It is important that as Country we continue to bear down on welfare costs. However the potential implications of these reforms may lead to a more transient community as result of fixed term tenancies, and a reduction in the supply of affordable new larger homes purely due the economics of cost and value as opposed to long term need.

There is a need for greater connection between macro policies which will support new supply as well as sustainable communities. There needs to be a better connect to housing and jobs and reducing transportation and energy costs for families. Creating real incentives for private house builders, local authorities and social housing providers to build homes which reduces the on-going live-in costs for customers rather than the current model which focuses predominantly on the initial cost of development.

## Financing of New Supply

Increasing housing supply to meet demand is a critical issue and one which should no longer continue to be seen as a lower priority to other key aspects of Government policy and expenditure.

We believe there are a range of steps that can be undertaken which will improve the supply new affordable housing.

### *Strong political vision and reshaping the market*

We believe there is an opportunity to re-shape the nation's policy and move away from the historical desire for owner occupation to a more balanced model where renting is seen as a more sustainable and preferred alternative.

Social housing providers own or manage nearly 2.5 million homes and rental income from social housing amounts to £10 billion per annum. The move towards an affordable rent model and the intermediate rent market will enable social housing providers to meet the needs of different but inter-connected markets.

Historically there has been a stigma attached to social housing, however in the past 20 years providers have invested significantly in terms decent homes and new supply. These new homes are predominately built to higher standards compared to the private market and in some cases have utilised technologies which have delivered better energy efficiency and reduced running costs for the customer and tackling fuel poverty.

We believe investment and government intervention strategies should be conducive to increasing the affordable rent market rather than an over reliance on purely increasing supply for private home ownership.

*Land Bank*

A recent report highlights that the UK's leading house builders have sufficient land bank to build almost 620,000 homes, of which less than 50% has been granted any kind of planning permission. Private developers are in essence restricting supply by the control they exert through these land holdings, which is partly driven by the proposed changes to the planning rules.

Social housing providers will have limited capacity to land bank, but do have the capacity to deliver new affordable housing immediately. As private developers suffer no cash loss from holding onto their land bank, there is no incentive to push these out into circulation.

We believe that large land banks should be subject to some form of tax levy as a form of disincentive which would act as a means of increasing supply of land into the market. This may also reduce pricing which continues to put pressure on the affordability of new social housing.

*Free/Discounted Land*

Local authorities and some quangos have significant free land or land which could be used for new housing as part of a wider regeneration programme. Some local authorities have taken a strategic approach and worked in partnership with social housing providers and offered free and discounted land to deliver much needed new affordable housing. These arrangements often require the social housing provider to ensure properties are available for customers on the local authority housing waiting list. This approach continues to work well as it helps bridge the financial gap in delivering new affordable homes. The important of this approach is further highlighted as result of the significant capital grant reductions announced in the Affordable Homes programme 2011–15.

Many local authorities have either continued to retain their surplus land holdings or offered them to the market with the express desire to maximise sales value. This results in land being acquired by private developers, as social landlords are unable to compete. However rather than new housing being provided from these sites, private developers will often land bank these sites for a considerable time, and by doing so have reduced housing supply in the area.

We believe there should be greater incentive for local authorities and those public sector organisations that have land holdings to balance their need to maximise return with the need to deliver new affordable housing.

*Deferred Land Purchase*

This is a relatively new approach which has been used very effectively by the Homes & Communities Agency. Essentially land is provided free or at deeply discounted rate initially, but with relevant parties taking the benefit of pricing usually associated with market sale properties at the end of the project. Projects funded through this approach have been successful, as the relevant parties work together to deliver new housing. They are able to take a strategic view of the housing market and adjust the delivery timescales to suit.

We believe more local authorities should adopt this model, which allows them to potentially maximise return on their land at some future point, but importantly it enables an immediate start to the delivery of new homes.

*Capital v Revenue Subsidy*

The reductions in capital grant in the most recent Affordable Homes Programme will see 80,000 new homes delivered for £1.8 billion. The available grant will inevitably place pressure on social housing provider balance sheets, which will require more private finance to fund the remaining gap.

There are uncertainties around future programmes and whether there will be move towards revenue subsidy model. Whilst it is difficult to judge the implication of such a move at this stage, this would change the relationship and potential risk profile between social housing providers and funders who have invested £43 billion in this sector.

Similar to the new affordable rent regime, which has seen significant variations and implications of charging higher rents across the Country as means of delivering more social housing units, a move to a standard model of revenue subsidy is likely to have some surprising regional variations, which may indeed hamper new supply.

We believe any move to develop a policy based on a purely revenue based model should be considered at regional and at local level. In the past 10 years we have already seen a substantial reduction in the number of social housing providers capable of delivering new homes, the danger with a revenue model may see this number reduce even further.

*Affordable Rents*

The implementation of the affordable rent model will increase rents to aid new supply. The regional impact of this policy has highlighted the continued need for grant funding in areas where the difference between affordable rents and social rents is minimal at best, or in some cases charging affordable rents would actually reduce capacity.

In the Midlands and North the emerging picture suggests some marginal benefit of charging Affordable rents, but not enough to see a stepped change in new supply. The picture elsewhere in the Country particularly London and South-East is more focussed around affordability of the new affordable rents by customers.

Our view is that, overall the affordable rent model will increase rents, but it will not deliver the stepped change required in new housing supply.

*Private Finance*

Social housing providers have been successful at leveraging private finance totalling £34 billion (Global Accounts 2010). We are starting to see a shift away from traditional financing structures to the bond markets. This is primarily driven by the availability of finance from what has become a sparse market.

Whilst pricing has increased, the real lack of traditional long term bank finance has seen social housing providers reviewing their strategic priorities and in some cases a move away from delivering new homes. In an attempt to re-capitalise, the Banks who have traditionally financed this sector are expressing their preference for short term financing, which inevitably means the social housing provider having to absorb more financing risk.

We believe the Government are in a unique position to directly influence the UK banking sector to increase availability. The provision of new affordable homes will not only meet the latent demand housing demand but also provides a much needed stimulus to the UK construction industry.

*October 2011*

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## Written submission from Hackney Council

1. Summary

1.1 Hackney Council is taking advantage of the Housing Revenue Account reforms by financing affordable housing supply to deliver over the next eight years a total of approximately 2,300 homes for social renting, shared ownership and private sale across 12 Council estates and sites. This replaces 853 homes for social renting, 21% of which are bed-sits and only 10 are family homes with more than three bedrooms. The programme will deliver 626 homes for social renting, and 484 homes for shared ownership, with the remainder for private sale. Of the affordable new build homes, 33% will be family-sized with three bedrooms or more, with 27.5% of the family-sized homes having four or five bedrooms.

1.2 The 853 homes for social renting have been providing accommodation for just over 2,000 people, however the combined total of the homes for social renting and shared ownership within this programme will provide accommodation for just under 4,000 people.

1.3 This programme will not only be delivered amid recession but also without reliance on Homes and Communities Agency funding. The programme is ultimately self-financing after initial starting costs are covered by the Council.

1.4 Overall the programme achieves a tenure balance of 49% for sale and 51% for social rent and shared ownership.

1.5 Regarding the supply of affordable housing more generally, Hackney Council has concerns about the introduction of a new Affordable Rent tenure—combined with the forthcoming benefit cap—as a means to continue the supply of affordable housing locally, and to house those on its waiting list in a borough where market rents have risen exponentially and larger, family-sized homes are in considerable demand.

2. Councillor Philip Glanville

2.1 Councillor Philip Glanville is Hackney Council's Cabinet Member for Housing, with lead responsibility for strategic housing, housing needs, and issues relating to Hackney Homes, the borough's Arms Length Management Organisation. Councillor Glanville has lived in Hackney for ten years and has represented Hoxton Ward since 2006.

2.2 Prior to joining the Cabinet he chaired the Living in Hackney Scrutiny Commission, which covers public realm, housing, regeneration, planning, culture, leisure and sustainability, and he led reviews into how to support and sustain the local high street, how to better involve Hackney residents in the planning process and how to encourage residents' participation in the work of Hackney Homes.

2.3 Councillor Glanville is in post as a Cabinet Member from June to December, 2011, as maternity cover provision for Councillor Karen Alcock, Deputy Mayor of Hackney.

3. Financial Overview

3.1 The regeneration programme across all tenures totals investment in excess of £400 million. Included within this are leaseholder repurchase costs, tenant home loss and disturbance payments, and development and works costs.

3.2 The investment for the affordable housing will be funded from a series of income streams:

- sales receipts from the initial equity share purchased within shared ownership properties;
- receipts from land sales where developments have been earmarked for open market home sales; and
- borrowings raised on the net rental income receivable from tenants and from shared ownership properties.

3.3 Build costs have been priced conservatively at a square metre rate that is higher than recent Council developments. We have chosen to be prudent on build costs due to increasing commodity prices, although labour costs are expected to remain static. Architect and other professional fees are based on industry standard percentages.

3.4 Land receipts are based on a combination of sales values, build costs and developers' profit margins.

3.5 With the downturn in the construction industry, we have already received significant interest from developers for the programme.

3.6 Payment terms will be negotiated on a site-by-site basis with each developer. It is expected that assisting developers with cash flows will result in increased land receipt values. A charge will be put on the land if land receipts are not received up front.

3.7 Interest rates are assumed to be 5.25%.

3.8 Rental income is as per the Government's rent restructuring regime. It assumes a 2% void rate and a 1% bad debt rate which is in line with rates for our current stock.

4. Cross-Subsidising Within the Programme

4.1 A number of the 12 estates and sites within the programme will cross-subsidise each other. An example of how the Council has recently achieved this to great effect is from January, 2011: a land deal totalling £25 million between Hackney Council and Lovell for two HCA-funded Local Authority New Build developments.

4.2 The Council contracted Lovell to build 87 new homes for social renting over two sites, after match-funding through prudential borrowing an HCA grant of over £6 million.

4.3 By the Council enabling an additional 42 private sale homes at one of the sites which overlooks Finsbury Park with a substantial Red Book value, Lovell will invest in the regeneration by undertaking the construction of 20 further Council-owned homes at another site, worth around £3 million, to assist in acquiring leasehold interests, which can be a significant cost before work can proceed.

4.4 This is thought to be among the first instances of a local authority cross-subsidising the development of sites in its property portfolio on this scale, as the mixed-tenure model is usually associated with major regeneration projects such as at Woodberry Down, or with housing associations.

4.5 Due to a 15-month deadline for development to meet grant requirements, Hackney put to the market a procurement package seeking bids from developers either to build the 87 social rented homes across the two sites, or to build the 87 homes plus private housing, and in return build a further 20 homes for Council ownership on the other site.

4.6 Market interest was considerable, and the Council also mitigated development risks by designing schemes ahead of procurement, to minimise planning risk; providing land at no cost, removing significant finance risk; and "buying back" the social rented units upfront through the HCA grant and prudential borrowing.

4.7 The Council will offer similar cross-subsidy across the 12 estate and site regeneration programme, to achieve similar benefits in future.

5. The Council as a Key Provider of Shared Ownership Homes

5.1 The eight-year programme will deliver 484 additional homes for shared ownership across the 12 estates and sites, which is expected to position Hackney Council as one of the major shared ownership providers in the borough, with homes for approximately 1,500 people.

5.2 Half are one- and two-bedroom properties, and the remainder includes those with up to four and five bedrooms, to offer current leaseholders in family-sized homes on regeneration estates an alternative to being bought out but then facing limited prospects of finding suitable local homes.

5.3 In this way the Council can not only mitigate against the high upfront costs of acquiring leasehold interests before regeneration works can get under way, but also help finance the regeneration through deposits and rent, making use of HRA reform.

5.4 In Hackney, low cost home ownership properties, notably those for shared ownership, are being squeezed out by the withdrawal of HCA grant and the need in turn for providers to focus on homes built for private sale to help fund developments. As a result, the Council through its estate regeneration programme is expected to become a major supplier of low cost home ownership properties up to 2015.

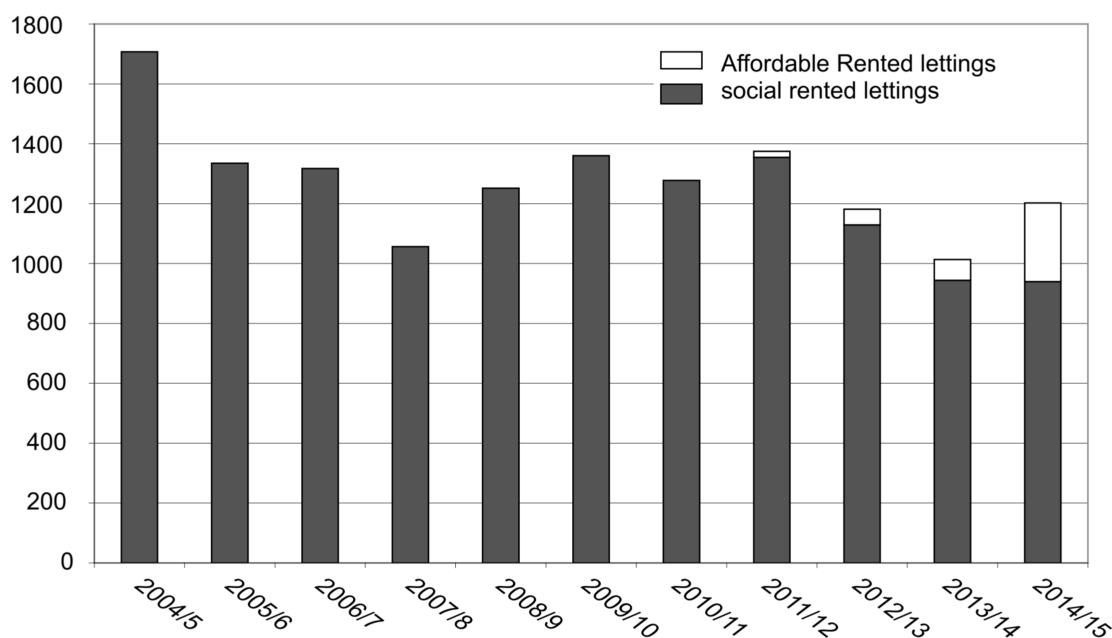
6. Housing Supply in Hackney in the Context of the Social Housing Reforms

6.1 Hackney has seen a building boom since 2005, peaking at an extra 2,500 homes in 2009–10. This was way above the Greater London Authority's annual target for Hackney of 1,085, and the second highest total in London that year. Demand is such that private renting has continued to surge despite rising rents, while owner-occupation levels do not appear to have grown since 2003.

6.2 The number of households in temporary accommodation nearly halved between 2005 and 2010, with a 60% reduction in severely overcrowded households on the housing register since 2007. This is mostly due to a high number of new homes for social renting built, and Council initiatives such as those to release family homes held by under-occupying tenants, and enabling homeless households to move into private rented accommodation. These reductions look set to go into reverse due to rising demand and declining supply.

6.3 An increase in homelessness applications is already under way and Hackney's Citizens Advice Bureau reports a rise in the number of private tenants seeking advice as landlords seek tenants who do not need housing benefits to help pay the rent. Other challenges going forward include the prospect of a continuing rise in market rents, as well as the effects of the new Affordable Rent model. Whilst the Council will do everything it can to respond to and mitigate the impact of these trends, they seem likely to continue over the medium term.

Social rented lettings available to the Council, 2004/5 to 2010/11, with estimates to 2014/15 that include early "best guess" estimates for RP lettings in Affordable Rented homes




6.4 Notes to graph:

(1) Lettings include homes becoming available for re-letting or which are newly built—but exclude (i) tenant transfers and the impact of estate renewal; (ii) lettings in new homes built for people with support or care needs; and (iii) lettings in new homes elsewhere in east London to which the Council has nomination rights.

(2) The estimates for Affordable Rent lettings are subject to change and depend on targets to be agreed between providers and the HCA in autumn, 2011.

6.5 To continue to ensure enough new affordable homes are built for residents, and to secure the best use of all housing sources, presents the Council with a number of challenges, especially as there are competing claims on the Council's land and resources, including Decent Homes works as well as many non-housing priorities. Registered Providers are also now being expected to make greater use of their assets and look across borough boundaries to build new homes.

## 7. The Role of Affordable Renting (AR)

7.1 As the graph beneath paragraph 6.3 reveals, there will be a projected 30% reduction in social rented homes available to the Council for letting from 2013, due to a big fall in newly built homes and providers converting an estimated 60 homes each year to AR when they become available for re-letting.

7.2 This shortfall means the Council has been looking at how it can make AR homes work for local residents in need. We have already issued interim guidance to our provider partners to help shape decisions made between them and the HCA on funding to build new homes, on the following issues:

### *Affordability*

7.3 Following research commissioned by the East London Housing Partnership, the table below represents what the Council asks providers to set as a maximum Affordable Rent, according to bedroom size, to ensure local affordability including for priority groups on the housing register. Lower percentages are being sought in high rent areas locally.

| *Bedroom size* | *Percentage of local market rents* |
|---|---|
| 1 bedroom | Up to 70% |
| 2 bedroom | Up to 60% |
| 3 bedroom | Up to 50% |
| 4 bedroom + | Up to 50% |

7.4 Research so far indicates that for those moving into employment, the above rent levels will not necessarily adversely affect households' disposable incomes when compared to social renting levels.

7.5 For example, single people in Hackney could potentially earn up to £20,000 per annum before higher rents affect disposable income; while for some families, especially larger ones, it could be up to £30,000, though this crucially depends on the impact of any child care payments and tax credit reductions.

7.6 Work on these issues is continuing, given the different rental markets operating in the borough, including checks that there is no threat of the Government's annual cap on benefits of £26,000 per family being triggered, notably on homes with four or more bedrooms. The Council is also exploring whether area-based rent thresholds or a borough-wide rent figure by bedroom size might improve outcomes.

7.7 Conversion of social rented re-lets to Affordable Rent The Council is concerned about the impact of HCA funding requirements to convert a proportion of social rented re-lets to the higher rents involved in AR. Providers have been asked that no more than 22% of all social rented re-lets be converted at this stage, and particularly not homes with three bedrooms or more.

7.8 Providers look set to focus AR on new one bedroom homes and to a lesser extent two bedroom homes. Homes converted to AR by providers when they become available for re-letting will start to appear later this autumn. Newly built homes will start to be let locally in 2013.

### *Target groups for AR*

7.9 The Council has stated to providers that it expects them to continue to accept bids through Choice Based Lettings (CBL) for AR tenancies from Housing Register priority groups, in line with existing protocols, while work is under way to develop a CBL affordability calculator for this. It is likely that most providers will seek to offer only fixed-term tenancies for AR lettings.

### *New social rented homes*

7.10 The HCA will only fund the building of new homes for social renting in exceptional circumstances outside of estate regeneration and some supported housing.

7.11 The Council has formally advised providers that 25% of newly-built homes should be for social renting, with the remaining 75% for AR. Responses from providers suggest that delivering this level of social rented homes will be particularly challenging, as no evidence has emerged yet that the HCA has agreed any exceptional cases. Several providers have advised that the Council may need to invest its own resources to help meet its 25% target, if funds from providers' reserves and cross-subsidy from sales of new homes built for private sale and low cost homeownership prove insufficient.

## 8. Funding from Private Developer Schemes

8.1 Subject to viability, Section 106 contributions from private developer schemes could help secure additional social rented homes. However, this will greatly reduce the sum total of new affordable homes of all types built. This impact will be even more pronounced if the contributions are to pay for social renting with three or more bedrooms, as these are more costly properties to build.

9. Planning Flexibilities to Aid Delivery of New Homes

9.1 The Council is considering a number of flexibilities in order to enable further delivery of homes both for Affordable Rent and social rent in the years to come. The Council's final planning position will be incorporated in a revised Affordable Housing Supplementary Planning Document (SPD), which is currently scheduled for adoption in April 2012, and will be reinforced through policies contained within the emerging Development Management Development Plan Document (DMDPD), currently scheduled for adoption in 2013.

*Area and site-based approach*

9.2 The current targets for three-bedroom or larger homes in the London Plan are 42% for social rent and 16% for intermediate. The Council's interim position is that, borough-wide, we expect the affordable rented programme (social rent and Affordable Rent), to meet the target of 42%.

9.3 The Council will assess tenure mix, population make-up and income, land values, average market rent levels, and scheme viability as part of the determination of planning applications, factoring in consideration of changes to the funding model for affordable housing, and also the neighbourhood or site characteristics.

*In-lieu contributions and off-site development*

9.4 This would involve making greater use of financial contributions for affordable housing in lieu of on-site provision and offsite construction of affordable housing—in specified circumstances and on condition that these help realise additional affordable housing and social integration.

9.5 This would include sites where there are existing concentrations of particular types of social housing and demonstrable benefits could be gained by providing new homes in a different location, such as to create more mixed communities, or provide a particular type of housing, such as family housing; or provide more units than is possible on the principle site.

9.6 Greater use of in-lieu payments in some circumstances could enable the provision of a higher number of affordable homes, including family homes, and a better mix of tenure on individual sites. This payment would go into a central affordable housing fund.

*Upward cascading*

9.7 This approach would reap benefits from increases to house prices, and involves building in to planning permissions a flexibility so that where higher-than-anticipated shared ownership or private sales values are achieved, the provider would guarantee to switch any shared ownership or open market properties to the affordable rented sector.

9.8 The Council could also consider receiving an in-lieu payment. Both approaches would need to be site-specific and take account of any implications the proposal might have for housing and estate management arrangements.

*Compact flats, or microflats*

9.9 These are smaller than the GLA Housing Design Guide standards which are required for affordable housing, and are sold below the corresponding average market value.

9.10 They are aimed at single people or childless couples, located in areas of high public transport accessibility, and built as part of a complex of similar homes. Compact flats can help reduce the demand to convert larger family homes into smaller units, and revenue generated can be used cross-subsidise affordable housing elsewhere in the borough.

9.11 The Council would need to be satisfied with the management arrangements and that below-market values are applied when any home is sold on. The support of the Mayor of London is also required for this approach.

10. Fixed Term Tenancies and the Council's Tenancy Strategy

10.1 The HCA requirement for providers to convert some existing social rented homes to Affordable Rent when they become available for re-letting, in return for funding for new developments, has prompted providers to discuss their policies on fixed term tenancies in advance of the statutory requirement for councils to produce their own Tenancy Strategy.

10.2 The Council will consult stakeholders on its draft Tenancy Strategy once the Localism Bill receives Royal Assent. The draft, already being shared informally with partners, makes clear that:

- no social rented homes should be let on fixed term tenancies, and that lifetime tenancies should continue to be used;
- lifetime tenancies should be offered in AR homes to all priority Housing Register applicants nominated by the Council via Choice Based Lettings; and

— a rationale be provided if a provider wishes to introduce a fixed term tenancy to an Affordable Rent home to which the Council does not have nomination rights, ie 50% of providers' one-bedroom re-lets, and 25% of re-lets with two-bedrooms or more.

10.3 Many providers are considering fixed term tenancies for AR lettings, mostly for five years and potentially longer in some cases. They generally expect to renew the fixed terms, but not necessarily in the same property, to address overcrowding or under-occupation issues that may arise in the interim. Further proactive initiatives to assist tenants into work are also being explored. For existing social rented tenants looking to transfer, AR homes on fixed-term will reduce the supply of homes to move to with lifetime security. Should this prove to act as a disincentive to move, it means in particular a reduction of social rented properties available for re-letting to help address overcrowding.

10.4 The Council will separately ensure social renting tenants wishing to move have the information they need should they be interested and be successful in bidding for an Affordable Rented home on a fixed term tenancy.

10.5 In 2012, Choice Based Lettings will be reviewed to take account of changing local and national trends and the Localism Bill. A new homelessness strategy will also be developed, in line with the draft Tenancy Strategy and the new London Housing Strategy. A forthcoming Government national housing strategy will provide insight into its housing objectives and how these can be balanced with Hackney's priorities, including in reducing overcrowding.

10.6 All of the above will be consolidated in a revised Housing Strategy due to go before the Council's Cabinet in April, 2012.

## 11. Conclusion

11.1 This delivery model, adopted by Hackney Council at a July, 2011, meeting of its Cabinet, maximises the number of homes built while minimising the need for Government grant, and nearly doubling the number of residents in social rented and shared ownership homes from just over 2,000 to just under 4,000 without compromising on design and space standards.

11.2 However, as with Registered Providers' making use of Affordable Rent-dependent Government subsidy, both the AR and Hackney Council models are medium term solutions. The Council will eventually run out of land values, and Registered Providers will eventually exhaust their borrowing ceilings, having stated that AR works for them only during this funding round. If Government grant is in as short, or even shorter, supply from post-2015, the risk remains that the supply of new affordable homes will gradually grind to a halt.

*October 2011*

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# Written submission from Nigel Grainge RIBA

## 1.0 Summary of Main Points

Q1. *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms?*

A1. Adopt an intermediate purchase mechanism that does not required public subsidy or capital, hence is not limited by the public purse.

Q2. *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms?*

A2. Recycle public sector investment to generate house after house.

Q3. *How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening?*

A3. Support/encourage public sector pension fund investment in housing and social infrastructure investment in their own locality.

## 2.0 Introduction

2.1 I am Nigel Grainge, an architect and the Affordable Housing Director working for the NPS Group, a public sector owned multi-disciplinary property consultancy that employs around 1,500 staff in 28 UK offices.

2.2 I come from a background of private sector architectural practice, have frequently led research into specific issues that inform the design and delivery of the built environment, and have specialized in working with community and other stakeholder representatives.

2.3 Since 2006, I have been focussing on research into affordable, low carbon housing. This has developed into a programme known as HEARTHuk which addresses both:

— the finance and delivery mechanisms that are needed to deliver new homes in this current economic climate, and

— the design and technical criteria that support affordable delivery those homes, homes that can be enjoyed.

2.4 We have successfully completed a HEARTHuk pilot scheme testing our design principles. They are CSH Level 5 homes and have achieved real value for money—built for around 80% of HCA target cost/sqm, and this has allowed them to incorporate good space standards.

The completed development has been evaluated by the Technology Strategy Board. An extract from the Executive Summary of that report follows:

> *"In terms of benchmarking, Malmesbury Gardens houses perform exceptionally well compared to other houses in the UK that have been evaluated through the BUS questionnaire methodology. The houses are very successful with tenants being appreciative of location, space, layout and overall appearance"*

2.5 We are currently working with public sector and private sector partners to deliver homes (generally CSH level 3 and 4) in London, Norfolk, and Yorkshire. These developments are in areas of differing property values and they employ a variety of different housing finance mechanisms.

2.6 I wish to draw upon this experience in providing evidence for the Inquiry.

2.7 Due to other work commitments, I have had to limit my submission to the initial summary of points. Naturally, I will be able to provide additional information and/or attend the inquiry, if invited.

### 3.0 Factual Information and Recommendations

Q1. *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms?*

A1. Adopt an intermediate purchase mechanism that does not required public subsidy or capital, hence is not limited by the public purse:

(a) Without first time buyers having access to an intermediate purchase mechanism and viable mortgages that require no more than 10% deposit, private sector development is likely to remain stalled.

(b) The NPS Group has devised a mechanism (HEARTHuk Intermediate Purchase mechanism) that lenders and CML reviewed favourably in 2010; it also requires no public sector capital or subsidy to make it work.

(c) We are further developing this mechanism and re-engaging in discussions with the lenders and CML.

(d) The design, space standards, adaptability, and expandability of the homes and the value for money achieved are vital components in achieving a beneficial loan to value ratio.

(e) We would be pleased to share details of this mechanism with the committee and/or its advisors. Further detail would need to be given in commercial confidence.

Q2. *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms?*

A2. Recycle public sector investment to generate house after house:

(a) We are currently working with public sector partners using public sector land and capital for housing in ways that generate a return and surplus which in turn can be recycled into the next phase of the development programme.

(b) The design, space standards, adaptability, and expandability of the homes and the value for money achieved are vital components of viability and marketability.

(c) We also have a proposal that focuses the capital spend on the locality (as opposed to an imported developer), providing training in low carbon building and then employment for existing local construction workers/businesses. Building work proceeds in smaller phases, to suit the current market, allowing capital and surplus to be returned and recycled. Creation of sustainable jobs and houses fed by money cycling through the local economy.

(d) We would be pleased to share details of the processes with the committee and/or its advisors.

Q3. *How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening?*

A3. Support/encourage public sector pension fund investment in housing and social infrastructure investment in their own locality:

(a) We are currently working with private sector partners that have access to private sector institutional and pension funds for development of new housing and social infrastructure.

(b) The public sector pension funds that we have contacted were, with the exception of one major fund, resistant to considering such investment, even though financial models showed there to be potential for them to meet their fiduciary responsibilities.

(c) We have introduced that one public sector pension fund into a study looking at the potential for creating a viable return from housing development.

(d) If this study has a positive outcome, as we expect it to, we advise that the Government should provide every encouragement for public sector pension funds to deploy and invest capital in housing and social infrastructure.

*October 2011*

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**Written submission from Professors Tony Crook[20] and Christine Whitehead,[21] Drs Ed Ferrari[22] and Gemma Burgess[23] and Ms Sarah Monk[24]**

SUMMARY

— In many ways S106 has proved to be a very effective means of helping to finance affordable housing as well as to ensure land is available and mixed communities.

— Planning obligations for affordable housing are now agreed on almost all "above threshold" residential sites.

— Nearly two thirds of all new affordable homes are delivered on S106 sites.

— A large proportion of the new homes agreed are delivered.

— This success has been significantly associated with the buoyant private market of the late 90s and mid "noughties" but also with the clearer policy and better practice of local planning authorities (LPAs) and the increased numbers of shared ownership homes (which require less subsidy).

— More recently the numbers agreed and completed have fallen whilst there has been an increase in the proportion which are social rented homes, but the numbers are still much higher than at the beginning of the last decade.

— Despite significant financial contributions by developers the successful delivery of affordable housing on s106 sites also needs significant public subsidy, RP debt funding and reserves.

— The introduction of CIL, allied with less favourable market conditions, new approaches to funding affordable homes and new policies in the draft National Planning Policy Guidance, may combine to reduce the numbers of new affordable homes secured through planning obligations.

— The big issue is how to maintain the delivery of affordable housing in the new very different environment. It is important not to lose local skills and commitment that have taken 20 years to build up to provide for local people. The new environment is challenging. But it remains a very useful tool especially linked to the affordable rents regime and the emphasis on intermediate housing.

INTRODUCTION

The Committee is inquiring into how new housing supply can be financed, especially within the new economic and financial environment facing private and public sectors. We are pleased to respond to the Committee's Inquiry and our memorandum looks specifically at the role that planning obligations have played to date in providing private finance as well as land for new affordable housing. It also looks forward to assess whether, in the light of recent changes, such as Community Infrastructure Levy (CIL), the funding made available for housing through planning obligations in the past can be maintained and indeed enhanced in the future.

BACKGROUND

S106 planning obligations have a long history. Initially they were confined to site mitigation and off-site infrastructure, but their use grew significantly in the 1980s because of reduced public expenditure for traditional public sector off site responsibilities and because using obligations to require developers to pay for the social costs of their new schemes (eg off-site roads) was seen as legitimate. Moreover, given the risks that developers could also be asked to pay for needs that were not "caused" by new development, government policy required obligations to meet specific tests of reasonableness. Using obligations to secure new affordable homes came later. Following limited experimental use by LPAs in the late 1970s and early 1980s, the government endorsed this, initially in 1989 for rural exceptions schemes and later in 1991 on all large (ie above threshold) residential development sites. This endorsement has been included in all subsequent government planning policy guidance on housing.

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[22] Dr Ed Ferrari is Lecturer in Town & Regional Planning at The University of Sheffield.

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[24] Ms Sarah Monk is Deputy Director of the Cambridge Centre for Housing & Planning Research, the University of Cambridge.

Provided LPAs establish the need for new affordable homes in local plans they can seek contributions from developers of all above threshold sites (and for smaller ones if their plans specify), provided the sites remain viable. Where developers are not prepared to make the provision, LPAs may refuse permission for the whole of the proposed development. They can set plan wide and site specific targets for the numbers of new affordable homes and sometimes also specify financial contributions, typically either free land for the subsequent provider of the affordable homes (usually a registered provider [RP] like a housing association) or specifying the price at which completed dwellings should be sold, usually the price that RPs can pay without public subsidy. However, not all LPAs negotiate financial contributions and many only specify the numbers of dwellings required (see Monk, *et al*, 2008).

Although developers can provide contributions on sites other than the ones for which they seek permission or make commuted payments to enable LPAs to secure provision on other sites, policy has been closely tied to governments' mixed communities agendas. Thus on-site provision of affordable homes on private sector development sites has been much preferred. Policy permits LPAs to negotiate a wide range of affordable homes for rent and for intermediate tenures (such as shared ownership) but no longer includes low cost market housing, partly because of the difficulties of securing the latter in perpetuity (Monk & Whitehead eds, 2010).

If the "burden" of funding obligations reduces the price developers are willing to pay for land, obligations are a de facto method of "taxing" development values. Landowners receive less for their land than if no obligations had been placed on developers and developers use this financial benefit to defray their obligations to LPAs. Because obligations are usually secured after negotiations between developers and LPAs they are, in effect, are locally negotiated levies hypothecated for local needs (in contrast to national levies on development values where the tax rate is set nationally and collected by a national agency with no hypothecation).

Whether planning obligations are an efficient and fair way of funding new affordable homes depends on a number of factors. Negotiations can impose additional costs on developers which can be seen as deadweight while the obligations to provide a mix of private and affordable homes may impact on the total private sector output and the types of homes produced.

In equity terms, obligations transfer responsibility for supply side housing subsidies from tax payers to owners of (mainly) above threshold development sites. Justification for this can be placed on the "taxing" of "betterment" (the land value increments that arise when planning permission is granted) earned where the supply of new homes is constrained, resulting in higher house prices and higher land values than in an unconstrained planning context. Low income households lose out whilst owners of development land benefit and RPs have to pay high prices for land. Hence using S106 to secure affordable homes can be seen as the pursuit of equity, taxing the beneficiaries of constrained planning policy to improve the housing circumstances of the low income households resident in these areas.

### Planning Obligations and Affordable Housing Secured: 1999–2010

In this section we summarise the findings of the research we done over the last decade examining planning obligations in general (Crook *et al*, 2006, 2008, 2010) and its use to secure affordable housing in particular (Crook *et al*, 2002, 2006; Crook & Whitehead, 2010; Monk *et al*, 2005, 2006, 2008; Monk & Whitehead, 2010; Whitehead *et al*, 2005). Where possible, we have also used readily available data to update some of the findings.[25]

*The key findings*

— While only 7% of planning permissions have planning agreements, the vast majority of large sites generate significant affordable housing—it is the small sites under ten units that rarely have contributions.

— Well over half of all planning agreements are for affordable housing—and in value terms there has been an increase of almost a quarter since 2005–06.

— The majority of provision is in the southern regions where pressure is highest.

— There has been a large shift to shared ownership and equity where little or no government subsidy is required.

*Total numbers of planning agreements and obligations*

Until this century planning agreement obligations were tied to very small proportions of planning permissions. While surveys in the 1990s noted a growing use, the numbers of agreements still covered only 1% to 2% of all non-householder[26] permissions (see sources quoted in Crook *et al*, 2010).

This century has seen a marked increase. Surveys from 2003–04 to 2007–08 (Crook *et al*, 2006, 2008, 2010) showed that between 6% and 7% of all non-householder planning permissions had agreements for obligations. The upward trend since the 1990s is due to the growing use of obligations for affordable housing having a knock-on effect in securing more obligations to meet other needs such as education (Crook *et al*, 2008, 2010).

[25] The most recent set of data on affordable housing comes from DCLG's HSSA statistics and the latest available data is for 2009–10 (that for 2010–11 is unlikely to be available until November 2011).

[26] Householder planning consent is required for proposals to alter or extend a single house, or for works within the boundary or garden of a single house. All other consents are here referred to as "non-householder" permissions.

The average number of agreements made annually by each LPA in England rose from 25 in 2003–04 to 30 in 2007–08 with major variations between and within different types of local authority, despite otherwise similar market pressures and socio economic circumstances (see below).

The majority of the S106 agreements are for housing developments rising from 18 per LPA in 2003–04 to 22 in 2007–08. Although this represented only 14% of all housing permissions over the period, the proportion was much higher for major developments (10 dwellings or more), rising from 40% to 51% over the five years. They also cover almost all large housing ones (in 2007–08 this included over 90% of those with more than 50 dwellings). The proportion was much higher in southern England than elsewhere, covering over two thirds of all major dwelling permissions in these regions compared with about one third elsewhere. This is because development pressure, development values and affordable housing needs are greater in southern England than elsewhere. Almost all (90%) were delivered in kind and not as commuted payments.

Since 2007–08 the global economic recession has been reflected in a fall in planning applications received and permissions given, albeit with a slight upturn in 2010–11. This reduces the opportunities for LPAs to negotiate obligations for affordable housing. In 2007–08 planning permission was given for 6,300 major residential applications, falling to 3,800 in 2009–10, with a small upturn to 4,200 permissions in 2010–11.

*Numbers and tenure of new affordable homes secured through planning obligations*

Table 1 shows the increase in new affordable homes approved through S106 obligations, rising from just under 14,000 in 1998–99 to over 48,000 in 2007–08. Increases occurred in all regions but especially in the four southern regions, accounting for over 70% of new approvals. Permissions fell to 35,500 in 2008–09 but then recovered to just over 38,000 in 2009–10. Despite this being lower than the peak year of 2007–08, it was still much higher than in 2003–04 when land values were approximately the same as in 2009–10 (see below). This suggests that local authorities were managing to sustain the numbers of affordable units delivered through s106 agreements despite the economic crisis.

Our evidence suggests that 80% of what is agreed with developers is ultimately delivered (Monk *et al*, 2006; Crook *et al*, 2010). Where delivery fell short of the agreement, this was generally related to changes to large residential schemes and also to the recent slower pace of development (usually provided for in “cascade” clauses in agreements). Table 2 shows that completions have risen from just over 9,000 dwellings in 1999–2000 to just over 32,000 in 2008–09 but falling to 29,000 in 2009–10, consistent with the fall in approvals a year before.

**Table1**

APPROVALS OF NEW AFFORDABLE HOMES ON SITES WHERE PLANNING PERMISSION HAS BEEN SUBJECT TO A S106 AGREEMENT

| *Region* | *1998–99* | *1999–2000* | *2000–01* | *2001–02* | *2002–03* | *2003–04* | *2004–05* | *2005–06* | *2006–07* | *2007–08* | *2008–09* | *2009–10* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| North East | 452 | 286 | 609 | 287 | 348 | 388 | 326 | 791 | 922 | 992 | 754 | 813 |
| North-West | 716 | 1,013 | 1,168 | 834 | 1,533 | 1,242 | 1,211 | 1,817 | 1,668 | 2,699 | 1,570 | 2,245 |
| Yorks/Humber | 555 | 691 | 356 | 835 | 962 | 1,427 | 1,996 | 1,914 | 1,860 | 1,980 | 1,482 | 1,982 |
| East Mids | 845 | 1,021 | 1,566 | 1,418 | 2,433 | 1,653 | 2,795 | 2,888 | 3,190 | 3,956 | 2,623 | 3,745 |
| West Mids | 1,759 | 1,032 | 838 | 1,099 | 1,532 | 3,242 | 3,148 | 2,933 | 3,621 | 3,264 | 2,655 | 2,294 |
| East | 1,637 | 1,978 | 1,814 | 1,895 | 3,598 | 5,008 | 4,857 | 5,696 | 8,135 | 5,362 | 3,915 | 4,963 |
| London | 2,662 | 3,508 | 3,648 | 6,433 | 5,853 | 9,374 | 9,701 | 14,061 | 13,357 | 14,376 | 11,099 | 10,270 |
| South East | 3,806 | 3,917 | 3,064 | 4,013 | 5,483 | 6,223 | 8,363 | 7,951 | 8,978 | 9,977 | 7,875 | 6,804 |
| South West | 1,460 | 2,083 | 1,705 | 1,666 | 1,985 | 3,078 | 4,219 | 5,326 | 5,437 | 5,539 | 3,530 | 5,022 |
| **ENGLAND** | **13,892** | **15,529** | **14,768** | **18,480** | **23,727** | **31,635** | **36,616** | **43,377** | **47,168** | **48,145** | **35,514** | **38,138** |

*Source*: CLG HSSA statistics.

**Table 2**

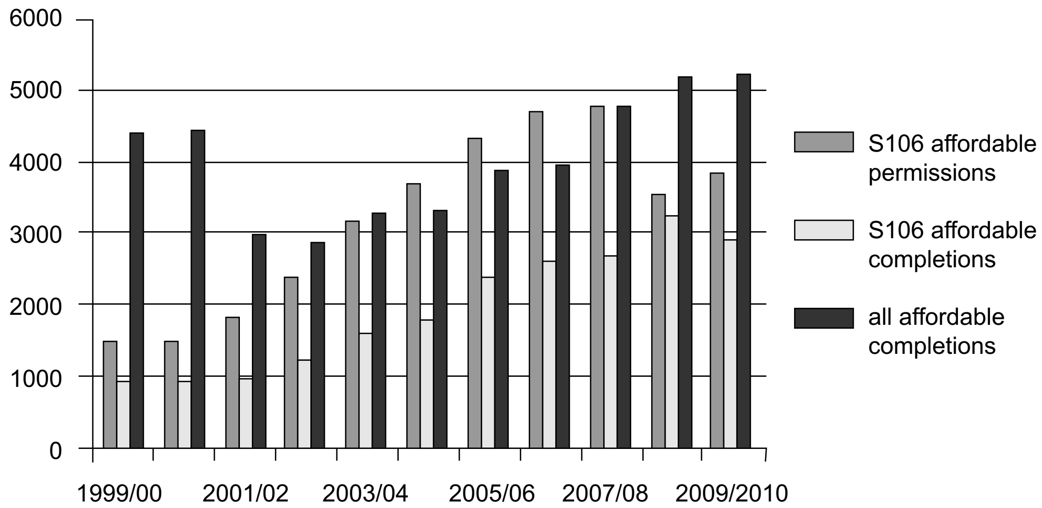
COMPLETIONS OF NEW AFFORDABLE DWELLINGS ON SITES WHERE PLANNING PERMISSION HAS BEEN SUBJECT TO A S106 AGREEMENT

| *Region* | *1999–2000* | *2000–01* | *2001–02* | *2002–03* | *2003–04* | *2004–05* | *2005–06* | *2006–07* | *2007–08* | *2008–09* | *2009–10* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| North East | 442 | 290 | 206 | 160 | 133 | 186 | 269 | 594 | 450 | 504 | 871 |
| North-West | 550 | 777 | 785 | 733 | 812 | 631 | 1,097 | 624 | 998 | 1016 | 1,145 |
| Yorks/Humber | 289 | 336 | 502 | 515 | 760 | 681 | 1,039 | 797 | 1,009 | 878 | 437 |
| East Mids | 691 | 778 | 761 | 1,155 | 898 | 1,294 | 1,914 | 2,089 | 2,605 | 2,601 | 2,471 |
| West Mids | 1,029 | 660 | 985 | 1,117 | 1,199 | 1,672 | 2,046 | 1,610 | 1,950 | 2,314 | 2,046 |
| East | 1,194 | 1,103 | 1,511 | 1,780 | 2,426 | 2,710 | 3,229 | 4,018 | 4,236 | 4,216 | 4,607 |
| London | 1,842 | 1,958 | 1,904 | 3,153 | 3,895 | 3,725 | 4,981 | 7,468 | 6,774 | 9,851 | 8,212 |
| South East | 2,553 | 2,298 | 2,394 | 2,923 | 3,577 | 5,327 | 6,168 | 5,569 | 5,884 | 7,439 | 5,912 |
| South West | 654 | 1,097 | 1,255 | 1,056 | 2,680 | 1,949 | 3,126 | 3,069 | 3,204 | 3,476 | 3,366 |
| **ENGLAND** | **9,244** | **9,297** | **10,303** | **12,592** | **16,380** | **18,175** | **23,869** | **25,838** | **27,110** | **32,286** | **29,067** |

*Source*: CLG HSSA Statistics.

**Figure 1**

COMPLETIONS OF ALL NEW AFFORDABLE HOUSING AND S106 AFFORDABLE COMPLETIONS




*Source*: CLG HSSA statistics

Figure 1 shows that the majority of all new affordable homes completed are now delivered through S106 obligations, increasing from 21% in 1999–2000 to a peak of 65% in 2006–07, though falling back slightly afterwards. This increase is as much the result of a fall in completions on other sites ("non S106 sites") as it is to the increase in S106 completions, which suggests that S106 was replacing, rather than adding to, the total of completions of affordable homes in the early years of the last decade.

**Table 3**

TENURES OF AFFORDABLE COMPLETIONS ON S106 SITES BY REGION

| *Tenure* | *Rent* | | | | | *Shared ownership* | | | | | *Other tenures*[1] | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Year* | *2001–02* | *2005–06* | *2007–08* | *2008–09* | *2009–10* | *2001–02* | *2005–06* | *2007–08* | *2008–09* | *2009–10* | *2001–02* | *2005–06* | *2007–08* | *2008–09* | *2009–10* |
| North East | 83 | 73 | 80 | 73 | 66 | 13 | 24 | 17 | 24 | 9 | 4 | 3 | 3 | 3 | 25 |
| North West | 63 | 46 | 29 | 57 | 67 | 11 | 37 | 49 | 37 | 20 | 26 | 17 | 22 | 6 | 13 |
| Yorks/Humber | 88 | 63 | 54 | 66 | 71 | 9 | 24 | 39 | 26 | 10 | 3 | 13 | 7 | 7 | 19 |
| East Mids | 59 | 54 | 50 | 64 | 59 | 13 | 40 | 43 | 32 | 23 | 28 | 6 | 7 | 4 | 19 |
| West Mids | 69 | 50 | 49 | 62 | 67 | 6 | 34 | 41 | 31 | 19 | 25 | 16 | 10 | 7 | 14 |
| East | 90 | 65 | 64 | 67 | 68 | 5 | 27 | 33 | 28 | 25 | 5 | 8 | 3 | 5 | 7 |
| London | 75 | 68 | 63 | 49 | 63 | 20 | 29 | 37 | 41 | 34 | 5 | 3 | <1 | 10 | 3 |
| South East | 78 | 57 | 57 | 55 | 66 | 20 | 35 | 41 | 38 | 30 | 2 | 8 | 2 | 7 | 3 |
| South West | 82 | 60 | 55 | 65 | 65 | 9 | 35 | 34 | 31 | 16 | 9 | 5 | 11 | 4 | 19 |
| England | 77 | 60 | 57 | 59 | 65 | 13 | 33 | 38 | 35 | 26 | 10 | 7 | 5 | 7 | 9 |

[1] Other tenures include discounted market sale units (up to 2007–08), local authority units and units of unknown tenure.

*Source*: CLG HSSA statistics.

Table 3 shows the tenure of new affordable homes delivered through S106. The proportion of social rented units fell nationally from 77% in 2001–02 to 57% in 2007–08 with a revival in 2008–09 and 2009–10. Meanwhile, the proportion that was shared ownership initially rose, although with a slight drop in 2008–09 and a bigger drop in 2009–10.

The proportions of shared ownership (and other intermediate tenures) rose for four reasons. First, central government wanted subsidy to lever in as much private finance as possible and to increase the overall numbers of affordable homes. Shared ownership has required much less Social Housing Grant (SHG) (Table 4). Second, LPAs faced targets to increase site densities, resulting in smaller flatted accommodation, best used as intermediate homes for smaller households (Whitehead & Crook, 2010; Bibby *et al*, 2011). Third, developers were happier to provide intermediate tenures because they regard key workers, and more generally employed households, as good neighbours for market purchasers. Finally, in a rising market, RPs found intermediate tenures highly profitable with sales proceeds being recycled into additional development. Many also cross subsidised their bids to provide social rented housing, so intermediate housing played an important role in increasing the overall supply of affordable housing.

In 2008–09 and 2009–10 these trends were reversed with greater proportions of rented than intermediate homes being completed in almost all regions. The economic crisis has made shared ownership units harder for RPs to sell, whilst stair-casing has also slowed down. Both have reduced RPs' capital receipts and impaired their assets, making it much more difficult to fund new shared ownership and to cross subsidise rented homes on S106 sites. At the same time the HCA's counter-cyclical "Kick Start" programme increased funding for social rented housing.

*The value of obligations for affordable housing*

The total nominal value of all obligations (including affordable housing) rose from £1.9 billion in 2003–04 to £3.9 billion in 2007–08. If the value of land contributions (apart from affordable housing) and for obligations related to minerals and waste is included, the total rose from £3.9 billion in 2005–06 to £4.9 billion in 2007–08 (data on these latter obligations were not collected in 2003–04).

Approximately half was for affordable housing, rising from £1.2 billion in 2003–04, to £2 billion in 2005–06 and to £2.6 billion in 2007–08. Extrapolating for the two years not surveyed, the total value of the affordable housing agreed between 2003–04 and 2007–08 was £10.3 billion (at 2007–08 prices). This was worth on average £54k per dwelling in 2007–08.

Despite these contributions, they have not wholly replaced the need for public funding, nor for contributions from RPs' reserves. Affordable dwellings are funded by a combination of developers' contributions, SHG, loans and reserves. The proportions vary considerably between sites, depending on market factors, the clarity of planning policy, the extent of other obligations sought, negotiating strengths of the parties involved and the type of affordable housing agreed—with shared ownership generally requiring considerably less SHG (Crook *et al*, 2002; Crook & Whitehead, 2010; Monk *et al*, 2008; Whitehead *et al*, 2005). In 2005, the range of developer contributions for social rented housing on s106 sites ranged from 32% to 55% of the total development costs (Whitehead *et al*, 2005). Developer contributions are generally at their greatest where LPAs' affordable housing policies require that completed dwellings are sold to RPs at prices that reflect dwellings' discounted net rental streams (Monk *et al*, 2008).

Three quarters of affordable homes on S106 sites have needed SHG since 1999–2000 and market factors have been keys to the need for public subsidy. Most S106 sites are in areas where land values are at their highest. Despite the size of developer contributions, SHG is still required to ensure that dwellings are truly affordable. S106 sites are in areas where RPs did not, in the past, build new homes because land prices were too high (Crook, *et al* 2006). S106 brings down these prices to what RPs can afford within subsidy cost limits (Whitehead *et al* 2005).

Another key factor has been the tenure of the affordable housing (Table 4). Shared ownership has required less public subsidy than social rented housing. Subsidy also varies by region, regardless of the tenure involved. Where "zero grant" on s106 sites policies have been pursued (eg Yorkshire & Humberside) large proportions of affordable homes have been delivered without subsidy. The overall economic environment is crucial and the proportions delivered without public subsidy fell in 2009–10, with falling development values.

**Table 4**

PROPORTION OF NEW AFFORDABLE HOMES COMPLETED BY RPS ON S106 SITES WITHOUT PUBLIC SUBSIDY

| *Region* | *Rented 2005–06* | *Rented 2007–08* | *Rented 2008–09* | *Rented 2009–10* | *Shared Ownership 2005–06* | *Shared Ownership 2007–08* | *Shared Ownership 2008–09* | *Shared Ownership 2009–10* |
|---|---|---|---|---|---|---|---|---|
| North East | 0 | 8 | 13 | 0 | 91 | 28 | 3 | 0 |
| North West | 20 | 28 | 26 | 9 | 47 | 52 | 32 | 4 |
| Yorks & Humber | 42 | 62 | 69 | 77 | 80 | 77 | 88 | 93 |

| *Region* | *Rented 2005–06* | *Rented 2007–08* | *Rented 2008–09* | *Rented 2009–10* | *Shared Ownership 2005–06* | *Shared Ownership 2007–08* | *Shared Ownership 2008–09* | *Shared Ownership 2009–10* |
|---|---|---|---|---|---|---|---|---|
| East Mids | 15 | 14 | 13 | 12 | 24 | 29 | 23 | 13 |
| West Mids | 45 | 58 | 38 | 20 | 66 | 73 | 51 | 13 |
| East | 12 | 22 | 25 | 8 | 30 | 33 | 31 | 4 |
| London | 13 | 12 | 2 | 6 | 16 | 19 | 3 | 7 |
| South East | 9 | 5 | 3 | 3 | 25 | 19 | 15 | 10 |
| South West | 16 | 20 | 24 | 13 | 29 | 32 | 33 | 12 |
| **England** | **16** | **18** | **12** | **9** | **32** | **31** | **18** | **9** |

*Source*: CLG HSSA statistics.

*Variations in Local Authority practice*

As well as variations in market context between different LPAs there are also differences in local policies and practices. Such variations reflect differences in formal and informal policy between authorities, and the skills and negotiating experience of staff (Crook *et al*, 2006, 2008, 2010).

A series of good practice studies (eg Audit Commission, 2006; CLG, 2006) and our own evidence shows that the growing formalisation of policy and adoption of good practice increases LPAs' abilities to successfully negotiate obligations. By 2007–08 almost all authorities had formal policies on planning obligations in place and there were statistical relationships between the adoption of commonly accepted good practices (eg standard charges) and the numbers of agreements, obligations and their value. "Good practice" local authorities also had more obligations delivered (Crook *et al*, 2010).

This all suggests that by adopting good practice, LPAs were in a strong position to take advantage of the buoyant market during the early and mid 2000s, hence the growing (but still modest) significance of market factors in explaining differences. It also suggests that good practice has been a key factor enabling new affordable homes to be secured through s106 even in the more difficult market circumstances of the latest economic crisis and that local policy and practice will be as critical a factor as market factors in determining outcomes under the new CIL and scaled back s106 regime.

## The Future: Changes to the Market and Policy

*The changes*

Two crucial changes (to the market and to policy) will impact on the ability of S106 to deliver affordable homes in the future—the market down turn and policy change.

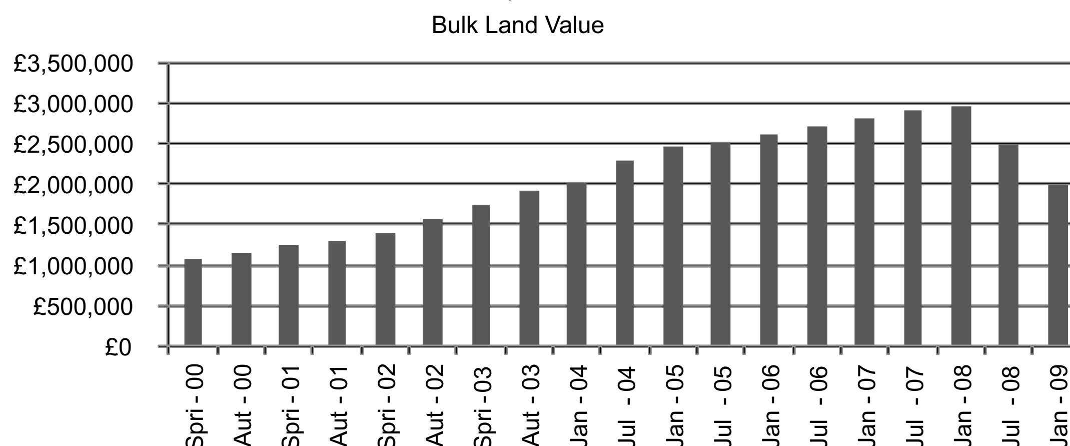
The big issues here are:

- Will there be any planning gain to use to support communities given the decline in land values? The answer is yes, when the economy starts to move, expectations will improve and values will allow some contributions—though not as much as in the past; and
- The shift to CIL as the major means of delivering planning gain could reduce the amount of affordable housing as other local priorities dominate—however LPAs have the experience to use S106 and it directly helps meet the "sons and daughters" issue.

The private market has experienced a downturn following the global economic crisis, reflected in a significant reduction in residential land values (see Figure 2).

**Figure 2**

AVERAGE BULK (2 HECTARES) RESIDENTIAL LAND VALUES IN ENGLAND & WALES (OUTSIDE LONDON) 2000 TO 2009




*Source: Valuation Office Agency Property Market Reports*

The average reached by January 2009 then stabilised at that figure for both January 2010 and 2011. Although values have thus fallen considerably from their January 2008 peak, they are still higher than in the Spring of 2000 (Figure 2) and it was over the subsequent period of rising values that LPAs were able to extract significant amounts for planning obligations. There has also been a fall in planning applications received and permissions given since 2007–08, albeit with a slight upturn in 2010–11, reducing opportunities for LPAs to negotiate obligations for affordable housing. In 2007–08 planning permission was given for 6,300 major residential applications, falling to 3,800 in 2009–10, with a small upturn to 4,200 permissions in 2010–11

Second, we are moving into a period of significant policy change—and the uncertainty it brings. Despite reforms to planning obligations policy being regularly mooted in the recent past, the "noughties" was a period of some stability in the ruling policy and legal framework for planning obligations. During this period critics of S106 argued that planning agreements lacked transparency and accountability, that negotiations were slow and made outcomes uncertain, that there was a growing disconnect between the obligations sought by LPAs and the development proposed and that there was a problem of free riders (ie the first developer of a new residential area risked paying for all the infrastructure required, with developers of subsequent stages benefiting from this at no cost to themselves).

Some of these concerns were addressed by putting s106 policies into statutory plans (making them more transparent and accountable), by standard charging (reducing negotiations and increasing certainty), by the five tests of reasonableness (ensuring legitimacy), and by allowing pooling of obligation receipts, but there were also consultations about more fundamental reforms, including a move to a tariff style system and a Planning Gain Supplement.

In the end a Community Infrastructure Levy (CIL) was introduced, coming into operation in April 2010 and giving "charging authorities" (primarily LPAs) a discretionary power to raise a levy on all new development to fund sub-regional and local infrastructure. If a LPA chooses to charge a levy, it will decide on the charge itself, subject to public examination, taking account of the infrastructure needed, what funding is available from other sources and the viability of development in its area. CIL will then run alongside S106, scaled back to address site mitigation and affordable housing, and this scaling back will happen everywhere after 2014, regardless of whether a LPA had adopted a CIL by then.

These new provisions explicitly accept that gains in development value should be used to fund infrastructure, that a close "rational nexus" between a specific development and its specific infrastructure needs is no longer necessary to do this and that an "averaging" approach to charging for infrastructure is desirable. This represents a considerable break with the S106 system described above. It increases equity, certainty, speed, transparency and accountability in using development value to fund infrastructure. But a key concern is whether the new provisions will hinder the use of scaled back S106 to secure new affordable homes.

There are also six other changes relevant to the potential impact of CIL on affordable housing provision:

1. First, CIL was introduced by the previous government and the Coalition government has modified the approach by requiring LPAs to give some of the CIL proceeds to the local communities where development takes place (hoping this will overcome some of the objections to new development).
2. Second, it has removed Regional Spatial Strategies from the hierarchy of planning policy and plans and placed all responsibility for local planning policies about meeting housing need (including affordable housing need) in the hands of LPAs.

3. Third, and in the hope that it will incentivise LPAs to grant more housing permissions, the Coalition has also introduced a New Homes Bonus for LPAs in the form of a fiscal incentive paid as additional council tax income for six years for each new home built (and 125% of the tax income for each new affordable home).
4. Fourth, although the substantial simplification of national planning policy guidance continues the existing endorsement of using planning obligations to secure affordable housing, it proposes to remove the national site threshold, to allow rural councils to permit an element of market housing development where this would facilitate the provision of more affordable homes, and to enable LPAs to decide on appropriate definitions of affordable needs when preparing their plans.
5. The Homes & Communities Agency (HCA) has stated that in future no grant will be paid on S106 schemes. This considerably strengthens its recent "default" policy of "zero grant" with strong justifications needed for any payment, for example because of exceptional costs or special circumstances (such as the extra costs of building in conservation areas, small rural sites or on sites needing substantial remediation).
6. Finally the adoption of the new affordable housing funding model with RPs letting new homes funded with subsidy at up to 80% of market rents changes what it may be possible for RPs to acquire from developers on S106 sites.

*The impact of Community Infrastructure Levy: a preliminary assessment*

It is difficult to predict impact because of the changed economic environment as well as the policy change but there are risks to securing contributions for affordable housing because, where CIL is charged, it will be fixed, not negotiated, so only the residual development value left over will be available for negotiating site mitigation and affordable housing contributions. LPAs are required to take the viability of sites to support affordable housing obligations when fixing the levy, but because of continuing concerns that not enough will be left over for affordable housing the Government has indicated that it would consider permitting CIL funds to be used for affordable housing (legislation would allow this but currently it is prohibited by the CIL regulations—and changes to these are currently subject to consultation).

Recent research with LPAs (Burgess *et al*, forthcoming) found that whilst CIL is broadly welcomed, there is a lot of uncertainty about the interface with s106 and the impact on how much affordable housing will be secured. Most LPAs were concerned about the overall funding gap for infrastructure, as what is collected through CIL will not be sufficient to meet all costs, and given this recognised that there will be a trade off between what can be secured through CIL, and what can be secured for affordable housing. This will be a balancing act and the balance between what is sought for infrastructure through CIL and what affordable housing is sought through s106 will come down not simply to viability, but to local political priorities. There is not only a trade off between what it is viable to secure through both the CIL and s106, but an opportunity cost in that the greater the proportion of affordable housing sought, the less can be secured through the CIL as it cannot be charged on affordable housing. There have been suggestions of using the CIL to collect contributions for affordable housing, but this was largely criticised by LPAs, mainly because it would not deliver on site affordable housing and would not support the development of mixed communities.

There will also be uncertainty while authorities decide whether or not to introduce CIL, at what level and how it is split between local neighbourhoods and sub regional and other infrastructure. If insufficient goes to the latter this may undermine provision of the infrastructure needed to support new homes. On the positive side, drawing in all sites to pay CIL should in principle enable more funds to be raised than was secured by s106 on only large sites in the past. This may allow a lower charge for CIL than the de facto "s106 rate" used on a much smaller number of large sites with planning agreements. If so, the amount left over for affordable housing may not be so badly reduced.

But given that development values have fallen so substantially since the credit crunch, it may well take a significant recovery in the market before scaled back s106 can deliver the amounts of affordable homes secured in the past. But as our evidence also shows how important to securing obligations it is to have effective policy and practice in place as well as to have high land values local policy and practice will be as crucial in the future as in the past. This may become more challenging and uncertain in the future because the draft National Planning Policy Framework removes the thresholds above which affordable housing should be required and gives LPAs much more autonomy in deciding on needs.

If the new market environment and new policy arrangements reduce the funds available for affordable housing, there will be pressure to secure more intermediate housing, and also demands on SHG to support contributions in the areas of greatest pressure. So we may have witnessed the end of an era when large amounts of funding was secured through S106 for urgently needed social rented housing. But it is still too early to be certain and a recovery in the market with an increase in development values should enable continued production of new affordable homes through S106 to continue.

Conclusions

— S106 has been very successful in a growing economy. It is still in place and helping to ensure social rented housing is produced.

— The affordable rents regime should make it easier to ensure S106 or CIL affordable housing contributions which even without financial contributions help mixed communities and ensure land is available.

— As the economy improves there should be greater opportunities both through S106 and CIL. There is a need to simplify the system but not to dismantle it.

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*October 2011*

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**Written submission from the London Borough of Newham**

Introduction

The London Borough of Newham welcomes this opportunity to share our experiences and concerns over the financing of new housing supply with the Committee. The key points we make in our submission are:

— Whilst we welcome the opportunities and freedoms presented by the HRA system reform and the Affordable Rent regime, we are concerned that there is a significant lack of funding available to build new housing across London and in particular affordable housing.

— The impact of the lack of funding could be mitigated through a series of freedoms given to local authorities: to prudentially borrow against future income streams, to charge up to market rents, and to keep the full receipts of sales of housing stock.

- If local authorities were given similar powers to those of housing associations, we believe we could make a substantial difference to the housing on offer to our residents. For example, we would like to improve the private rented sector by buying up street properties and offering longer-term tenancies. We are also keen to improve the financial resilience of our residents by helping them onto the housing ladder with a shared equity scheme or deposit scheme.
- We are concerned by the government's recent announcement of a further discount for Right to Buy tenants and a replacement house for every property sold. Whilst we strongly support the principle that social housing tenants should have the opportunity to buy a home it remains unclear how new housing will be built to replace the properties sold. We would urge the Committee to press the government on details of this scheme and ensure that Councils have enough finance to carry through the promise of replacing homes sold under Right to Buy.
- We also offer a number of practical solutions for improving the level of housing supply.

1. *Providing the biggest return on the investment, in housing supply terms, from the more limited public subsidy*

The cuts to funding of new housing supply are severe, and as discussed below, are not sufficiently mitigated by the affordable rent regime method of financing new supply. Nationally only £4.5 billion is available for the four year period in contrast to £8 billion for the previous three years. This amounts to less than £21,690 of HCA grant finance per dwelling. It is worth noting that for the 2008–11 investment period which has just ended, Newham secured £320 million of investment for affordable housing in the borough with grant levels for social rent closer to £150,000 per property. Relatively high levels of grant in 2008–11 encouraged new supply and helped keep rents at affordable levels for Newham residents.

However there are ways in which the Government could significantly increase the supply of housing. Firstly, amending the timing of payment of grant to start on site rather than completion would reduce affordable providers borrowing costs, and improve their cash-flow.

Secondly, providing freedoms regarding the ability of Councils to raise finance, charge appropriate but varying rents, and build out a full range of rented and sales homes would make a huge difference not only to the supply of new housing but to the ability of Council to shape and improve neighbourhoods. More details on the freedoms we seek are outlined at points 6 and 7.

2. *The role of state lending or investment, as opposed to grant funding, and the appropriate balance between them*

The Committee needs to examine the use of "staircasing" receipts held by housing associations from the sale of retained equity in low cost home ownership schemes to ensure they are maximising the re-investment return into new supply.

Where grant or land is provided by the state, then it should see a share in the uplift arising from future sales, with this return being ploughed back into new supply.

Local authorities should be enabled, encouraged and funded to develop a range of intermediate products that address the various and numerous needs of their individual housing markets. This would increase tenure diversity and possibly allow cross subsidy to deliver family units across all income groups.

3. *The role of, and barriers to, the public sector in providing support in kind*

Previous attempts to encourage Councils to identify surplus land for development have not always met with success, but enabling them to be the direct beneficiaries of development activity would overcome this. We are keen that any development projects meet with our more general housing and community aims, ensuring that our residents will benefit from development.

Councils need to be able to develop the full range of tenures on their land in order to make developments viable and to offer a range of options to residents. For example so-called PFI Lite deals using institutional funds (as discussed in point 4) where the authority becomes the owner of the accommodation at the end of the finance term would encourage institutions to move into the sector and authorities to make best use of its land and other holdings.

4. *Bringing long-term private finance into the private and social rented sectors*

Newham is keen to intervene in the private rented sector as it represents around 35% of the housing market in the borough. This private rented sector housing is often of low quality. We estimate there are over 4,000 private landlords in the borough and there is evidence of unscrupulous landlords operating. We would like to be able to offer our residents a secure, good quality option in the private rented sector both through new build and buying up street properties.

We believe that securing institutional or pension fund finance looking for a steady return and diversification away from the volatility of the FTSE and other stock markets will deliver investment into new housing supply. Newham is currently investigating starting such a scheme working with a private partner/investor or other. We

would seek to buy up street properties in areas of low quality PRS, or equally the scheme could fund new build for private rental use. The properties would be let out at market rents, offering a high quality offer to residents in the private rented sector which could include longer-term tenancies (if required) and the security of having a Council special purpose vehicle managing the property.

Newham would like to be able to offer assured or assured shorthold tenancies on purchased and new properties. This would allow us to be flexible in managing the properties and allow us to maximise revenue for PFI lite investors. It would make our aim of achieving a high quality private rented sector realisable, by removing the council's market disadvantages in relation to buy to let investors.

We are keen to deliver this programme of activity but procurement of the joint venture needed for delivery can be costly in time and procurement costs. Standard drafting from the Treasury/Infrastructure UK (to ensure private as well as public sector buy-in) would speed up agreements.

Alternatively, if local authorities issued bonds to finance this activity we could secure finance at lower costs, enabling us to build in headroom to mitigate its risks. In addition, these models are predicated on delivering rent-only schemes, so other approaches will be needed to generate other tenures and sales products. These are discussed below.

5. *The role of Housing Associations*

Housing associations have staircased receipts that could be better used. The housing association sector could better address its day to day costs to free up revenue to finance more supply. Registered providers (RPs) should be encouraged to finance their projects over the total life of their schemes ie up to 60 years to reflect the actual assumed life of the properties. RPs should assist and work jointly in partnership with local authorities to deliver new housing

Many "affordable rents", ie ones that are above 60% of market rent, are unaffordable for Newham residents in larger homes. We believe that the balance between rental income and capital, in the development of new supply, must be increased in favour of capital to improve affordability for low and middle income families. In addition this rebalancing should apply to council led development programmes.

6. *Increasing funding after the reform of the council Housing Revenue Account system*

One of the key changes government could make is to enable local authorities to keep all of their receipts from sales activity as long as it is re-invested into new supply. Ending the practice of the Treasury receiving 75% of receipts from sales to Council tenants would give local authorities a valuable resource to invest into new housing for residents. The current system means that money raised from the sale of our stock cannot be ploughed back into housing and our residents miss out. Right to Buy receipts should be retained by local authorities to provide new supply, in lieu of the units sold.

The government's recent announcement of an improved offer for Right to Buy tenants, followed by a guarantee that any homes sold will be replaced, raises a number of concerns over how that promise can actually be carried out. Whilst we welcome the government's announcement in principal, here is an urgent need for government to offer more detail around debt repayment. Our initial analysis suggests that currently Newham would only receive £22,500 for each Council home sold once debt post HRA reform has been taken into account, and 75% has gone to the Treasury. Other considerations to take into account are the need for land to build on, the type of property that is built as a replacement (for example if it is a family home that has been sold, a family-sized property would need to be rebuilt), the level of rent the properties are let at and the lag between selling a property under Right to Buy and building a new property. We would also welcome more discretion in making Right to Buy more clear and transparent to applicants before they buy.

We would strongly urge the Committee to raise these issues with government to ensure social homes are not lost.

In addition, we are concerned that the Debt Cap has been set artificially low and has no regard to the borrowing capacity that local authorities could prudently manage. At the very least it should be subject to a review mechanism and annually inflated. Local authorities could also develop out low cost home ownership schemes on our own land using the resultant receipts to build out other sites and so on, on a rolling basis. This would ensure we had a constant flow of new build properties coming on stream.

Finally, we would suggest pooling borrowing capacity and headroom so that there is no overall increase to the national debt as activity remains within the permitted ceiling. This would assist local authorities who have capacity to develop but no headroom to build using the headroom of other authorities who have no in-borough capacity.

7. *The Government's "Affordable Rent" proposals and long-term funds for new supply*

As noted above, the Affordable Rent model of financing new supply does not mitigate for the lack of funding for affordable housing. As discussed at point 1 there are ways that the limited funding available could be put to better use with changes to the timing of payment. In addition we are concerned that the level of borrowings this regime requires is not sustainable in the longer term with gearing levels leading banks to mitigate their

risk by increasing the costs of loan finance to Registered Providers. This in turn puts pressure on the RPs and reduces their development capacity.

We are also concerned that essentially financing the Affordable Rents for residents who cannot afford it will come through housing benefit. From our initial analysis it appears a significant number of our residents would be pushed into benefit dependency in order to pay the Affordable Rent. It would be better to make the Affordable Rent a truly new and intermediate offer, whilst maintaining an appropriate level of social rents.

The Committee may care to establish how many housing association homes will be sold to generate funds to help them deliver the HCA's 2011–15 Affordable Housing Programme. This is clearly not sustainable in the longer term and will encourage the sale of affordable homes in high value areas, which will reduce the opportunity for people of all incomes to live in the same neighbourhood and reduce the number of mixed communities in London.

The big win would be in allowing local authorities to prudentially borrow funding in a sustainable way, through increasing rents on our existing stock. Local authorities should be given greater freedoms to set rent levels on re-lets that would enable us to fund new supply. We need to be free to sweat our assets, and be given the range of freedoms that housing associations enjoy to develop and sell housing. As well as this we need to be able to let our properties at market, Affordable and social rents to reflect the greater needs of the area and the role Councils have in re-balancing local housing markets.

*October 2011*

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## Written submission from East 7

East 7 is grateful for the opportunity to contribute to the Communities and Local Government Select Committee inquiry into the *Financing of New Housing Supply.*

Policy relating to housing finance is of the highest interest to East 7 and its tenants. For the purposes of this inquiry, we will focus on six main points in this paper which presents our response to the questions posed:

(1) Affordable Rent.

(2) Long-Term Private Finance.

(3) Universal Credit and direct payments.

(4) Availability of land.

(5) Targeting of limited capital/public subsidy.

(6) Right-to-buy.

We would of course also be very happy to provide the Committee with Oral Evidence, should this be helpful.

We hope the Committee finds our comments useful.

### About East 7

East 7 is an informal alliance featuring nine of the largest developing housing associations based in the six counties that comprise the East of England.

The creation of East 7 was driven by the high demand for affordable housing but lack of supply in the area. In the East of England the ever increasing imbalance between average household earnings and the costs associated with buying a home mean that many households cannot get a foot on the housing ladder and is the cause of overcrowding and homelessness.

As a result, we felt that housing associations across the region needed to come together to continue to play a vital role in providing homes at sub-market rent or part-purchase to households who would otherwise be unable to find housing.

Our members are Aldwyck Housing Group, bpha, Circle, Crosskeys, Estuary, Grand Union, Hightown Praetorian & Churches Housing Association, North Herts Homes and Swan Housing Group.

Together, we manage over 135,000 homes across the East of England, and in the last year alone we built over 4,000 homes and re-let 8,613 properties. Collectively our members currently employ more than 4,000 people.

### Executive Summary

— Housing associations will not be able to charge 80% market value rates in all areas. As a policy, it is also unlikely to cover the loss in funding and may have unintended consequences.

— There is an urgent need for policy certainty around the levels of capital funding that will be available to housing associations post-2015. If the Government is committed to tackling the huge under supply in housing, a consistent approach to delivery is required. A stop-start approach could be disastrous. Housing associations need to be able to plan for the future, both in terms of their structure and the focus of their activities, and in order to have the confidence to approach markets for private finance.

- — The Government needs to allow flexibility of financing and allow housing associations to explore innovative funding, such as disposal and management of assets, issuing bonds, subsidisation through private arms of housing associations, and institutional and private investor borrowing.
- — Direct payments under universal credit will create funding uncertainty with lenders at a time of economic turmoil and potentially will increase management costs and risk for landlords.
- — More pressure needs to be brought to bear on local authorities to release land for the generation of housing supply, and wherever possible this should include the potential for *Build Now, Pay Later* or similar mechanisms which will enable development.
- — Where limited capital is available, thought must be given to focussing it on those areas of high demand, that are key engines of growth.

1. *Affordable Rent: 80% Market Value Rent*

East 7 acknowledges that the affordable housing sector must recognise the constrained fiscal environment in which we are operating in. As a result of this, the Government must prioritise how resources are used in order to ensure value for the money it spends and there is a need for an increased role for housing associations, and other non-state providers, to assist the Government in achieving this.

Prior to the election, and then subsequently, we advocated granting housing associations flexibility over tenants' rents in order to generate additional resource. Our recommendations focused on enabling housing associations to generate additional resources to invest in local priorities, and reintroducing a degree of rent flexibility to enable housing associations to invest in improvements to housing without over-reliance on government funding.

We therefore welcomed the Government's move in this direction with the introduction of the affordable rent, albeit with greater restrictions than anticipated on how that income stream is used.

In coming years, we hope the Government will consider allowing greater flexibility so that housing associations can invest the revenue in ways that are best suited to the needs of the local community, rather than just new build. For example, by developing green spaces and playgrounds; making a range of improvements to existing homes, such as building extensions to increase occupancy-capacity and incentivising under-occupiers to voluntarily down-size to free-up much needed capacity for families and develop green spaces and playgrounds to create vibrant communities.

In terms of its implementation, the majority of our members are likely to be able to charge their tenants the 80% market value rent. However, in areas of higher demand and higher rental prices (eg Cambridge), we will only be able to charge 50–60% market value due to affordability and local housing allowance constraints.

We would caution however that even in those areas where larger revenues will be created as a result of the 80% market rate, there will remain a significant funding gap created as a result of the decrease in capital grant. One reason for this is that the 80% market rent value includes service charge, whereas the social rent calculation adopted by the Government does not. This is especially significant, as it impacts most heavily upon the smaller units which are most needed in terms of combatting under-occupancy. This means the actual income for housing associations is lower than estimated by the Government. This is likely to lead to longer term reduced capacity in the sector and thus leading to funding problems for increasing housing supply if the current system continues.

It is this on-going policy uncertainty around the availability of capital grants, which severely restricts housing associations in their long-term planning. We are keen to understand government preferences for capital or revenue support to enable the provision of more affordable housing in the post-2015 models—and in this regard how flexible the Treasury may be in considering options which may include tax breaks to encourage investors, the use of social impact bonds (see section 2), or measures which may impact on housing benefit—or whether there will be a re-thinking of the role government wishes to play in the provision of housing, and whether there will be a shift in focus from increasing supply and with it the benefits of an economic stimulus to increasing the quality of existing stock.

As a further issue, East 7 members are also concerned that those on the social housing register may not believe homes offered at 80% market value rent is a viable option for them. This is because of the added risk that, if they do accept and find employment, housing benefit will be withdrawn and they will be left in a worse financial position with high rent. Housing associations must therefore address the question of who affordable rent is aimed at, for example, should working families be a priority, or should there be an affordability policy eg 35% of income.

Finally, how far each association will be able to travel down the path of higher rents for a greater proportion of their residents will depend on their understanding of their social purposes and objectives, and we may be entering a period during which housing associations must think long and hard as to its target "market".

2. *Long-Term Private Finance*

**Bank Lending:** In the current financial climate, it is becoming increasingly difficult for housing associations to provide the type of security which lenders are looking for.

Recent research by Policis showed that 35% of tenants are not confident they would be able to keep up their rental payments, further compounding fears by banks that the stability of housing association's rental income would be impacted upon by benefit changes (see section 3). Housing associations thus become unattractive borrowers and a significantly higher risk.

This new position is worsened by the lack of certainty around capital funding, meaning housing associations are unable to provide a solid business plan post-2015 (see section 1). If there is inadequate capital, housing associations may well face higher lending rates, tied to the increased risk. In addition, in the mixed tenure business, the lack of mortgages available to first time buyers will impact upon, and limit, cross-subsidy options.

**Private Rented Sector:** Expansion into the private rented sector has been a limited, but viable option for some housing associations and there remains throughout the country, a demand for good quality landlords. Indeed at least one member of East 7 has been successful in doing so, holding around 200 market rented homes.

However, due to restrictions in place on charitable bodies and private income, there is a limit to which this can generate income before becoming a threat to charitable status.

With increasing scrutiny of standards in the private sector, Government may wish to look again at providing an incentive for housing associations to increase their involvement. Housing Associations are well placed to provide a service for private markets and assurance to government of an accredited landlord service.

Even if the Government does not wish to go down this avenue, East 7 believe that more attention needs to be paid to ensuring high standards in the private rented sector—with over half of the housing benefit bill being paid to private landlords, it seems anomalous that the requirements that social landlords are expected to fulfil are not also demanded of the private rented sector.

**Bonds:** A number of East 7 members have now moved to issuing bonds or other means such as private placements to access the capital markets to raise capital to support new house building programmes. However, raising private finance in this way is currently restricted by its attractiveness to investors. It is not currently tax efficient for the bond-buyer, so return on investment for them is not as high as it could be. Once again, the attempts of housing associations to bridge the funding gap are artificially constrained.

**Tax-exempt retail Bonds:** Retail bonds could also be considered by the Treasury as a potential way for individual investors to support housing associations and the development of their communities. As housing associations are not for profit, we would suggest that these bonds are made tax-exempt, to provide a strong incentive for individuals to invest in a good cause which will still generate a healthy return, as opposed to a for-profit organisation. This would assist in bridging the funding gap, with a limited burden on the Treasury, while still providing much needed social housing.

**Social Impact Bonds (SIBs):** East 7 is also interested to understand whether the Department for Communities and Local Government will, like other Departments, be considering the potential for Social Impact Bonds following trials in the East of England at Peterborough Prison, and with some key local authorities.

As a form of payment by results, but with upfront funding for particular initiatives, it is worth exploring further whether the impact that good social housing schemes—where architecture is used to design out certain social problems combined with support services that housing associations can provide—could be supported by SIBs. This would drive innovation and a focus on how initiatives could be joined up to tackle for example worklessness, or ill-health, and the social problems which are often concentrated amongst social housing tenants, whilst insulating the Government from the cost of paying for ineffective schemes.

We do not envisage that this form of funding could be used to generate a large supply of housing stock, but believe it is worth exploring both in terms of driving innovation and best practice. For example, the funding could benefit supported housing which is more expensive than mainstream housing. This type of housing requires higher management, repair and maintenance costs, which may act as a disincentive to housing associations to provide such accommodation. Yet, there is a real need for housing associations to build supported housing such as sheltered accommodation. Supported housing incentivises older tenants to down-sizing and can thus free up much needed larger housing units. Increased focus could also be concentrated on the wider impact of housing on communities and life chances. Much will depend on agreement on outcome metrics and a methodologically robust approach.

East 7 therefore calls for willingness by the regulator and the Government to explore lateral funding, as the current model could act to restrict any genuine long-term financing opportunities for housing associations.

3. *Universal Credit: Direct Payment to Tenant Policy*

East 7 understands the intentions of the Government in introducing the universal credit, but does not support the proposal to make direct payments to residents the default position. Direct payments to the landlord can be a prudent household budgeting mechanism for low income households in the same way as direct debit payments work for mortgage holders. As benefit accounts (for those tenants who would not automatically qualify for a bank account) do not currently have the option of a direct debit facility, in our view, direct payment to landlords

simply replaces this facility for social housing tenants and helps tenants avoid arrears as their rent is paid automatically and on time.

Although reassured by Lord Freud's comments at the National Housing Federation (NHF) Annual Conference in September, direct payments will lead to an increase in rent arrears. This increases risk to housing associations' income and therefore decreases the chances of continued funding from lenders (see section 2).

Moreover, research by Policis (commissioned by Big Issue Invest, a financier of social enterprises and supported by the NHF) has found that tenants do not want the burden of direct payment. The national survey of 1,000 social housing tenants found that 80%[27] of tenants surveyed, thought the Government's proposal to pay housing benefit direct to tenants was a "bad idea". In addition, 35%[28] of tenants are not confident they would be able to keep up their rental payments. This confirmed fears of lenders that the stability of landlords' rental income would be impacted by the changes.

In addition, tenants have further concerns regarding how housing benefit is paid: the payment will move from fortnightly payment, to monthly. Over half (54%)[29] of tenants believe under this system, it would make it more difficult for them to manage their money.

If the Government insists on moving forward with direct payment, we would be keen to see a trigger mechanism developed to stop payment if default occurs. This should be as early on in the default process as possible to prevent large financial shortfalls. Whatever trigger is decided upon, it needs to be a simple mechanism that both housing associations and tenants can clearly understand. For example, a "three strikes and you're out" rule.

4. *Availability of land*

**Planning Reform:** To support the call for affordable housing, there needs to be more land made available to provide affordable homes. We believe that housing associations are capable vehicles for delivering positive outcomes and value for money solutions to both central and local government. The identification of land by the DCLG which will be made available for housing is very welcome but, with much more land held by local authorities, does not go far enough. We also recognise the dilemma facing both central and local government in respect of the disposal of these assets at commercial or reduced values. We believe that future housing and financial strategies need to give close consideration to the potential impact of both options.

The Government's initiative to survey and log previously developed land which is now vacant or under-used owned by local authorities will help to some extent, as will new powers such as the Community Right to Reclaim Land, and reform of the Public Request to Order Disposal Process. The latter will, it is hoped, reinvigorate local communities into action using these powers.

However, East 7 would question whether the reformed Public Request to Order Disposal process, routed through the Secretary of State, on a case by case basis will generate the land necessary for housing need. To ensure progress, East 7 would recommend increased pressure on local authorities to voluntarily release land for development, preferably on a *Build Now, Pay Later* or discounted value alternative scheme which will favour the development of social housing. This would alleviate some current housing pressure and stimulate the construction industry, as well as reduce the potential for housing associations to have to spend an increasing amount of resource on developing the case for the disposal of land

5. *Future targeting of limited capital*

**Housing Grant:** Any current or near future uncommitted housing grant should be focused where there is highest demand for affordable housing: there is no easy way to change the natural flow of tenants and even when given freedom of movement, tenants will move where job opportunities are high—but this also means housing prices reflect this.

Concentrating limited capital on those areas which are key engines of growth, such as the East of England, will deliver a more profitable outcome for the country, the economy and provide the workforce to achieve growth in these areas.

6. *Right-to-buy*

Briefly, following recent announcements regarding extending right to buy and the increase in the discount, it is worth being aware of the impact this may have on housing associations (due to its application to stock transferred from councils). It will affect housing associations asset base and their ability to leverage finance.

*October 2011*

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[27] http://www.insidehousing.co.uk/tenancies/most-tenants-want-housing-benefit-paid-direct-to-landlord/6517756.article
[28] Ibid.
[29] Ibid.

## Written submission from Genesis Housing Association

SUMMARY

1. Development of submarket rented homes is possible only with subsidy. If this is to be limited, the government will need to look at what the purpose of subsidy is, as at too low a level, it undermines its own purpose. Possible uses for existing or future subsidy could include using it solely in the development of this type of housing; less subsidy implies less submarket rented homes, and may be considered an indication of the level of commitment to providing homes of this tenure.

A broadening out of provision/eligibility of submarket homes to households that would traditionally have been expected to access home ownership but now cannot—generation rent. Alternatively the government could look at using existing grant in production of new homes for people unable to access home ownership, with the broader intention of stimulating the economy. This would provide more economically and socially mixed communities, as well as cross subsidy to ensure affordability and sustainability in the long term.

2. The market is not willing or able to produce homes at submarket rents. It would be difficult to see scope for complete withdrawal of state lending to provision for this client group. Grant could be used by the state as investment in a social investment fund, using it as "seed money" rather than grant allocation. All monies in this fund would be ringfenced for financing housing supply.

To maximise state lending/investment the government should look at ways to reduce barriers for the sector in raising additional investment funding from other sources. Writing off grant and changes to the methodology used in valuing socially tenanted homes are two major issues that would support the sector in offsetting the reduction in grant, helping raise more investment capital in the medium to long term.

3. Support in kind eg land, can only be provided once. This type of support will need to be based on the actual market value of the support, with an agreed financial return on it, so this can be sustainable and not only a one-off. Local authorities may also wish to invest part of their income in a ringfenced social investment fund, or provide support in kind in other ways to support financing of new homes where the market will not.

Where the private sector is not willing to invest, there should be recourse to public sector finance if where there is housing need. Guarantees may reduce the perception of risk in these cases.

Exploration of alternative models such as mutuals will require guarantees in order to be viable. In principle they are complementary to the housing sector, although to date have not been successful in competing for contracts/tenders in other areas, such as in the health sector and banking.

4. Larger housing associations have been successful in issuing bonds to provide long term finance. There is scope to look at the affordability of this approach, with exploration of local or national government taking on the role of a guarantor/broker to assist in providing long term finance for housing supply.

New developments will need to be mixed tenure to attract private investors. Revenue raised from private homes would cross subsidise affordable and target rented homes.

5. There is possible disjoint between the long term regeneration objectives of housing associations, and the relatively short term need to maximise return to a private sector investor. This could be overcome by subdividing large scale projects into phases, to ensure both parties' objectives are met.

Without some investment eg through a social equity fund, there may be less scope for local authorities to negotiate the number of homes at certain tenures. A further review of how allocations operate in a local authority area, for example by mixing the types of tenure in any future development, may increase the possibility of investment across a local authority area as these become less risky for private investors.

6. Local authorities will have a greater role in commissioning existing operators and direct capital to them, or consider local authority bonds to attract a range of schemes and housing associations. There is also scope to invest monies in a social investment fund which would be ring fenced. There may be a risk of mission creep as local authorities prioritise other areas of spending.

7. Affordable rent provides some funds against a backdrop of cuts. It is a resource hungry model, requiring private borrowing and higher rents elsewhere to offset the relatively low level of subsidy.

This particular product has created some challenges for housing associations. At its current level, with our current client group, affordable rent is not likely to provide the increased revenue stream expected.

An alternative definition of affordable rent, which provides for both target rent and affordable/intermediate rents, is urgently needed. Benchmarking pros and cons against the government definition of up to 80% of market rent, and an alternative sector definition of 35% of net income,[30] as well as others from other quarters, would be a good first step in assessing the long term sustainability of funding and of affordability to prospective residents of the affordable rent model.

[30] "Where next?" Housing after 2015: Creating a Sustainable Housing Investment Model, London and Quadrant Housing Association.

1. *How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on investment, in housing supply terms*

1.1 It is clear that any production of sub-market rent homes requires subsidy of some sort. The fact that there is an issue with scarcity of provision indicates clearly that private sector players either cannot or will not deliver this type of provision within the current economic and regulatory framework. With this in mind the government might wish to consider whether, if subsidy is limited, whether it should be aimed solely at the provision of target rent homes. A consequence of this interpretation of policy is that only the number of new build homes available at sub-market levels will be equivalent to the proportion of subsidy in any development. This in turn has implications for the level of subsidy government is willing to commit to provide homes where others cannot or will not. In order to ensure sustainability (and affordability) of housing, the government may wish to consider whether it is appropriate to compel housing associations to provide the shortfall, and where the loss will be borne if more homes are expected at sub market rents.

1.2 There are a growing number of households who would have traditionally been expected to access home ownership but cannot in the current economic climate. Housing such households helps to create mixed communities and greater sustainability both socially and economically. The government should look at whether the time has come when the purpose of the subsidy system, whether capital or revenue based in the future, needs to be redefined. An alternative to utilising this more limited subsidy to produce housing at sub-market rents is to apply it to stimulate growth more generally in the production of new housing for households unable to access home ownership.

2. *What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them?*

2.1 Housing development is a capital-intensive business. The production of housing at sub-market rents requires a subsidy of some sort, where the market quite clearly neither willing nor able to develop housing at these rents. Put simply, removal of subsidy for housing development will mean an end to (in the short term) homes available at target rents and (in the long term) homes available at affordable rent. It is difficult to see scope for complete withdrawal of state lending if homes are to be provided that are affordable across all tenures.

2.2 A possible approach is to learn lessons from the private sector and look at appropriate investment or lending within the public and housing sectors. In an era when grant is not guaranteed, it may be possible to look at the government using their lending/investment as seed money, levied through a social investment fund. In this model, housing associations, government, the HCA, local authorities and the GLA (in London only) would pool monies to form a single fund. Either individually or collectively, housing associations and local authorities would be able to borrow money, to then use as seed capital for development. Investment in a social investment fund would be a sustainable approach, generating long term finance for housing development. Housing associations and local authorities (relative to their size) who contributed to this ring-fenced fund would be able to borrow in order to develop a range of innovative housing products at a range of rents and tenures.

2.3 It might be beneficial to examine the benefits of writing off historical grant in order to make housing associations' balance sheets more attractive to private investors.

3. *What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening*

3.1 One challenge for the public sector in providing support in kind is that a resource such as land can only be given once. In order for support in kind to be sustainable, there needs to be an agreed mechanism so a situation is avoided where there is no assistance from the public sector, be it either financial or support in kind. It may be possible that support in kind would form part of the investment in a social investment fund. In order for the model to be attractive to prospective private sector investors however, these would need to be valued at their market price. For example, support in kind of a piece of land from a local authority would need to be accurately valued to allow full and transparent calculation of the return for any investor; any financial return is based on the value of the land in this example. This would also allow a local authority or landlord to accurately anticipate the level of financial return at the end of the project.

3.2 In instances where a landlord or local authority identifies housing need but they are not able to attract private investment (either because the investor does not consider it worth investing or a higher level of cross subsidy is needed to make a project financially viable) there should be recourse to public sector support. In cases such as these, the government will need to consider what happens in situations where there is effectively market failure of provision and yet housing need, how to fund and develop socioeconomically mixed communities.

3.3 The challenge may be one of perception; in those cases where there is no other investor, public sector guarantees will be invaluable in ensuring development goes ahead. It would be in these cases where the government would need to consider financial as well as non-financial assistance. The question will be whether these are given at a local or national level. The reform of HRA opens up the possibility that these can be locally determined and therefore be more responsive to a given situation on the ground. Housing associations and local government would be able to aggregate their investment finance and work either in a commissioning

partnership, or through a special purpose vehicle, where local authorities will be incentivised to take on more of the risk than they currently do now, in order to guarantee the number of homes they require.

4. *How long term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to this happening?*

4.1 Some larger housing associations have in the past issued bonds. In Genesis' case this has helped us raise a significant amount of long-term finance. Whilst this has been successful, it may not be possible in other cases to do this. With the introduction of direct payments and increased expectations from the government to finance development through private borrowing, there is a strong possibility the impact will be negative on housing associations' credit ratings. Perceptions that in the medium to long-term housing associations' credit ratings agencies' downgrades will mean increased borrowing costs, diverting monies from existing tenants and stock. This type of finance may not be cost-effective in the long term if rates significantly change, and means this by itself this cannot be a remedy. Long term affordability of private finance is a major barrier that could be addressed with government intervention at some level, to take on a guarantor/broker role for a longer period of time perhaps for longer than bond markets alone may be willing to accept. For smaller housing associations, this type of assistance would make their longer-term projects viable also.

4.2 The current economic situation provides an opportunity to consider a social investment fund approach to funding development. Implicit in this approach is the fact that all future development would need to be mixed tenure in order to be financially viable and provide a return for investors. Any investor returns would be based on revenue from private homes, with the cost of affordable/target rented homes cross subsidised by this. This approach also has the potential to address issues of concentration of single types of tenure in developments, be they social, rental or privately owned.

4.3 One obvious challenge is to marry up the long-term finance needs of housing development schemes with expectations on relatively short term return on investment required by the private sector. Two examples of this are Woodberry Down (London Borough of Hackney) and Grahame Park (London Borough of Barnet), both mixed tenure long term regeneration schemes that will take approximately 20 years to complete. Phasing of this type of wholesale neighbourhood regeneration into projects may be part of a solution to do this, but other considerations such as ensuring a holistic approach to place enhancing schemes whose development involves both the public realm and housing, which may be at odds with an the desired outcomes of a private sector investor.

5. *How housing associations and potentially ALMOs might be enabled to increase the amount of private finance going into housing supply*

5.1 Special purpose vehicles have in the past been used to varying levels of success within the sector. The benefit of this approach to the private sector is that at the outset projects would be risk assessed and their returns calculated. This would be a huge shift from looking at large scale vision to smaller scale deliverable project delivery with predetermined financial outcomes predicated on private and social housing delivery. For this approach to work, large-scale development projects undertaken by housing associations, would need to be further compartmentalised into projects to assess the return on investment for private finance for each phase. Private investors that invested in projects seen as high risk would expect a higher rate of return than those assessed at a lower risk. In most cases private investors would take on revenue risk, with a social investment fund/local government taking on the capital risk.

5.2 One of the beauties of the current system is that finance can be raised on the strength of an association's balance sheet. A compartmentalised system where finance is provided on a project-by-project basis, making development finance extremely disjointed. Masterplanning on the scale of Woodberry Down (4,600 homes) and Grahame Park (5,000 homes) would simply not be feasible using a project-by-project approach, and there would be real risks that large-scale regeneration schemes would not be realised.

5.3 One significant challenge with this model is that within a single development or single local authority area projects that are similar in size and scope will carry different levels of risk, affecting the viability of development at all in some cases. Where the appetite for private investment is low, it will be for the government/local authorities to provide housing within that community. A reformed allocations process that takes this into consideration and levels the playing field will mitigate any further residualisation of social and housing association homes, through mixed tenure allocations by local authorities and housing associations.

5.4 For local authorities under pressure to deliver more social housing this approach would mean less scope in negotiating the number of homes per unit at certain tenures, unless there is a clear contribution either financially or as support in kind.

6. *How the reform of the council Housing revenue account system might enable more funding to be made available for housing supply*

6.1 With the reform of housing revenue accounts (HRA) local authorities should in principle be able to better determine how to reinvest their surpluses on provision of more council housing. There will be a need for vigilance in ensuring monies are allocated so as to ensure proper maintenance of existing stock, as well as

investment in new homes. The challenge will be how to do these two things, and simultaneously ensure debts or loans are serviced.

6.2 With more freedom to allocate monies to directly providing homes, local authorities will be able to commission more homes. This raises the prospect of more local authorities raising money through non-traditional financing. Where a local authority has a number of housing associations or developers, it may be possible to consider a local authority bond, where local authorities act as guarantor for any scheme. This has the advantage of ensuring that monies are available to both maintain and develop homes, freeing up capital to invest. One risk is that monies previously ring-fenced are in future used in areas other than housing. Given the current economic climate and the challenges faced at a local level in service provision, there is a strong possibility of mission creep.

7. *How effective the government's affordable rent proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium and long term*

7.1 The affordable rent programme does provide some support for a development programme against a backdrop of severe national economic constraints. The cut to the housing programme for 2011–15 is some 63% compared to that for 2008–11. For housing associations, prospective and existing tenants, the affordable rent model as it is being currently implemented is problematic. The key problem of long-term viability is that affordable rent is a resource hungry model. Grant levels in the new programme equate to 15–20% of the cost of development; upwards of 85% of development costs need to be found from a combination of increased income from higher rents, reserves or other resources and private borrowing. HCA constraints on conversion of properties to this new tenure and raise income means the burden of raising development income falls to housing associations' own resources and ability to borrow or raise development finance, something that is clearly not sustainable in the long term. Housing associations will, in the medium to long term, reach their capacity in terms of what can be raised against their assets.

7.2 In order for this product to be successful, the government and local authorities will need to square the circle of who exactly is affordable rent aimed at. A product such as affordable rent is not suitable for current or prospective tenants who are allocated housing through choice based lettings. Without input into allocations, it is difficult for housing associations to extend the affordable rent product to, for example, people that previously were eligible for intermediate rent through housing options or under the current firststeps portal. In order to make affordable rent effective, for the government and local authorities to achieve their housing objectives, a commitment must be made to develop for both target and affordable/intermediate rent levels, and have one system of allocating accordingly, that housing associations have some sway over.

7.3 We believe there is urgent need to look at alternative definitions of affordability. An alternative, costed definition of 35% of net income should be considered.[31] For a person on an average income, this equates to a rent of £170 a week. Clearly both this lower figure and the current definition of up to 80% the sector is working with have pros and cons in terms of what they can actually deliver in the long term. It is clear however that a reliance on rental income alone to develop and build new homes is not feasible in respect of investment in new housing in the long term, and that defining affordable rent at up to 80% of market rent will not necessarily increase funds over the long term if people cannot afford to rent the homes developed.

7.4 If, as seems the direction of travel, housing associations and (should they decide to develop) local authorities will be expected to attract investment income from sources other than the government, the lower affordability definition provides more stability in both income and in tenancy. Full modelling of the current definition, this alternative definition offered by the sector, and other suggestions should be considered to accurately define what an affordable rent is, and what the implications are for current and prospective tenants, housing associations, local authorities, and prospective private sector investors.

*October 2011*

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## Written submission from the Scottish Government

### Executive Summary

The Scottish Government welcomes the opportunity to offer evidence to the Communities and Local Government Committee's inquiry into the financing of new housing supply. Increasing the supply of all types of housing is fundamental to achieving our 2020 vision of a housing system which provides an affordable home for all.

This memorandum, focused around the questions posed by the Committee, highlights the range of innovative approaches we are taking to support the delivery of housing of all types and tenures and maximise the impact and leverage of our investment. In addition, where appropriate and relevant, it raises concerns about policy areas reserved to the UK Government which impact on the Scottish Government's capacity to deliver on our objectives. In particular it highlights difficulties related to the UK Government's plans to reform housing benefit, and the pressing need for action to increase the availability of higher loan to value mortgages to credit

[31] "Where next?" Housing after 2015: Creating a Sustainable Housing Investment Model, London and Quadrant Housing Association.

worthy borrowers throughout Scotland. Without the ability to influence these key drivers of the overall housing supply system in Scotland, our capacity to deliver our objectives is hindered.

In addition to the above, key points raised in our response include that:

- The Scottish Government believes that there remains an imperative to support the delivery of affordable housing. Within that, given the scale of need, we believe that the clear majority of investment should be in the form of grants to support housing for social rent. We have made a commitment that at least two thirds of the 30,000 affordable homes we intend to support the delivery of over the next five years will be for social rent.
- There is however significant scope to reduce the average level of subsidy provided to social rented housing by encouraging providers to make full use of the other resources available to them. As an example of this, awards of funding made this year through our Innovation and Investment Fund have had an average per unit subsidy level of £40,000, compared to a previous level of around £70,000.
- Whilst grants will comprise the bulk of our investment, the drive to maximise the leverage achieved through our funding demands that we make use of other investment approaches, including guarantees, equity loans and other forms of loan arrangements.
- We are therefore also developing a range of innovative approaches that will support the delivery of other forms of affordable housing. In particular, the National Housing Trust initiative is on track to deliver hundreds of new homes for intermediate rent for a Scottish Government investment, costed at only £2,700 per unit of potential outlay through guarantees.
- In addition, we are continuing to invest in shared equity schemes, have launched a £10 million Housebuilding Infrastructure Loan Fund to unlock stalled sites and have announced support for the development of a private sector mortgage indemnity scheme.

### Introduction

1. The Scottish Government welcomes the opportunity to offer evidence to the Communities and Local Government Committee's inquiry into the financing of new housing supply.

2. Increasing the supply of all types of housing is fundamental to achieving our 2020 vision of a housing system which provides an affordable home for all. Our recently published housing strategy and action plan, Homes fit for the 21st Century,[32] made clear the need to increase supply right across the housing system, including expanding the availability of mid-range housing products to support the growing number of people whose needs aren't met by the established tenures.

3. The credit crunch and subsequent economic downturn have had a significant impact on housing supply in Scotland. Private sector housebuilding in particular has fallen dramatically given the decline in mortgage lending and uncertain economic climate, and the overall level of funding available to the Scottish Government has reduced significantly. Over the course of the next Spending Review period, the overall level of capital investment allocated to Scotland from the UK will decline by some 36%.

4. In response, we have actively pursued an innovation agenda with housing partners to identify new methods for financing and delivering new affordable housing, focused on securing the maximum possible leverage for our investment. In addition, we have taken action, within the limits of our powers and responsibility, to support private housebuilding and the housing market more broadly.

5. Difficult decisions have had to be made in pursuit of our goal, and we have laid down a significant challenge to housing providers throughout Scotland. However, given the pressing ongoing need to increase the supply of affordable housing in Scotland, there is no other realistic option.

6. Our actions are now beginning to bear fruit. From a standing start, local authorities in Scotland are now building almost as many council houses as the rest of the UK combined. We have developed the highly innovative new National Housing Trust initiative, which will enable hundreds of homes to be built for intermediate rent, support hundreds of jobs and maintain activity in the housebuilding industry. We have significantly reduced the average levels of subsidy used to support social rented housing, and identified a range of potential new approaches for the future.

7. Taking account of the initiatives we have put in place and the position in Scotland, the response below offers the Scottish Government's views on a number of the questions posed by the Committee in its call for evidence.

*How and where should the more limited capital and revenue public subsidy best be applied to provide the biggest return in housing supply terms?*

8. The Scottish Government believes that there remains an imperative to support the delivery of new affordable housing in Scotland and that our investment should reflect that. It is a vital strand of our efforts to build a better and a fairer Scotland, address homelessness and affordability issues and continue to regenerate

[32] http://www.scotland.gov.uk/Publications/2011/02/03132933/0

our most deprived neighbourhoods. As such, despite the reductions in capital spend for housing necessitated by the UK Government's cuts, we have prioritised over £600m for new housing over the next three years.

9. Within that, in contrast with the UK Government's approach, we believe that there is a compelling case for continuing to support the delivery of homes for social rent. Initiatives to support the supply of all forms of affordable housing are important, and we say more about that later in this response, but social rented housing plays a vital role in providing people with an affordable home and a platform for getting on in life. Accordingly, of the 30,000 affordable homes we intend to deliver over the five year term of this Scottish Parliament, at least 20,000 will be for social rent.

10. By its nature, social rented housing is the most expensive form of affordable housing in terms of the Government subsidy it requires. However, our experience suggests that there is real scope to support it at a much lower level of subsidy than has previously been the case. We see significant opportunities for housing associations and local authorities to bring other resources to the table in producing their bids for funding—for example by drawing on existing borrowing capacity, through cross-subsidy, by reducing costs, or by justifiable increases in rents.

11. The recent awards of funding from our Innovation and Investment Fund[33] make clear the potential to increase the leverage of our investment in social rented housing. This one year challenge fund, focused on driving innovation, collaborative working and value for money to the Scottish Government, elicited a large number of competitive bids from councils, housing associations and other bodies willing to contribute resources to affordable housing developments.

12. In all, the total grant of £142 million from the three strands of the Innovation and Investment Fund is levering in a total of £349 million from other sources, and delivering over 4,300 homes. Of that total, almost 3,200 new social rented homes will be supported, at much lower rates of subsidy than had previously been possible. The subsidy benchmark for housing association developments has dropped from around £70,000 to around £40,000 per unit, resulting in those associations needing less in public subsidy compared to last year's subsidy rates. And many councils are working with us to develop new social housing at still lower levels of central Government subsidy.

13. The challenge funding approach has stimulated innovation in the wider system and allowed a wide range of organisations to show their willingness to embrace change. However we recognise that the approach does not suit all partners or provide longer-term certainty. We are therefore now working together with partners to see how we can build on the achievements of the fund, whilst also meeting shared objectives for a longer-term programme approach. As part of that, we will continue to expect a benchmark of £40,000 subsidy for housing association developments. Higher levels of subsidy will be available only where absolutely necessary for priority developments that would otherwise be unviable.

14. In considering the longer term picture, it is worth highlighting the damaging impact that changes to housing benefit could have on both the financial model underpinning investment in Scotland's social rented sector, and the types of homes which can be supported. Housing benefit currently meets two thirds of the total rents in the social rented sector in Scotland (£1 billion) and can meet up to the 100% of rent for people on low incomes living in it.

15. The Scottish Government fully understands that housing benefit must be affordable for Government. However, housing benefit expenditure in Scotland has remained relatively level in recent years. Our stakeholders are extremely concerned that the changes planned by the UK Government to introduce direct payments to social landlords, if not implemented with sufficient safeguards, threaten to undermine the attractiveness of the social rented sector to lenders.

16. In addition, the Department for Work and Pensions proposal to introduce penalties for social sector benefit claimants under-occupying their property cuts right across the Scottish Government's investment focus on homes of two bedrooms or more which can offer "homes for life" for our social tenants. The Scottish Government has made its opposition to this proposal clear and will continue to do so.

### Other Approaches to Affordable Housing Supply

17. In addition to driving greater leverage in our investment in social rented housing, the Scottish Government is leading the way in developing innovative new approaches to other forms of affordable housing. We see significant scope here to increase the impact of our investment and harness new sources of finance to support housebuilding, whilst still focusing on those in most need.

18. In particular, the Committee may be interested in the National Housing Trust initiative (NHT),[34] an entirely new model for funding affordable housing which we have developed with the Scottish Futures Trust, local authorities and the housebuilding industry. The NHT is founded on a risk-based approach which requires much smaller public subsidy than is the case in other approaches to affordable housing—costed at only £2,700 per unit of potential outlay through guarantees.

[33] http://www.scotland.gov.uk/Topics/Built-Environment/Housing/investment/innovationfund
[34] http://www.scotland.gov.uk/Topics/Built-Environment/Housing/supply-demand/nht

19. The first round of procurement for the NHT involved 12 Councils across Scotland last financial year, and contracts are now signed, or underway, to deliver nearly 500 new homes. This will boost Scotland's economy by as much as £70m and help to support 800 jobs.

20. The initiative uses local authority borrowing to part-fund new homes built by private sector developers, with the Scottish Government acting as a guarantor for Councils' loans. Developers take the rest of the risk on new homes brought into the scheme. To qualify for our help, the rents have to be lower than both the usual market rates and housing benefit subsidy limits, thereby helping lower income families. As developers will sell the homes in one go to the scheme as soon as they are completed, they can more easily attract sufficient bank working capital to unlock stalled developments and banks can de-leverage their balance sheets.

21. The first phase of the NHT has proven the concept and encouraged engagement in innovation, and Councils are keen to see the model applied more widely. The housing association and private developer sectors are keen for a version of the model to be developed directly for the housing association sector, and have co-produced options with us which were the subject of summer consultation.

22. In addition, to support the development of new innovative approaches we launched a £10m "Innovation Fund" strand as part of the overall Innovation and Investment Fund. This fund, open to a very wide range of bidders and not just the housing association and local authority sectors, aimed to support innovative proposals for the delivery of all types of affordable housing. A number of complex, potentially transformative and larger-scale proposals involving institutional and other new forms of investment are being proposed as well. Officials are actively considering those bids further with the organisations that proposed them.

23. Finally, we continue to see a role for supporting new supply and first time buyers through the use of shared equity schemes. Our schemes are targeted at priority group applicants on low to moderate incomes which include social renters, members of the armed forces, veterans and widows, widowers and other partners of service personnel. A recent evaluation of our shared equity schemes concluded that they are reducing pressure on the social rented sector through freeing up properties and reducing demand expressed through housing lists. Under our innovative New Supply Shared Equity with Developers Scheme, the Scottish Government and a developer each hold a security over the proportion of the home they have funded. This enables us to help first time buyers to access home ownership for considerably lower public subsidy.

24. Our shared equity schemes differ from the English schemes in that buyers do not have to pay any interest charges after five years. Buyers in Scotland can receive assistance from the Scottish Government (and, where applicable, its developer partners) of up to 40% of the purchase price, whereas in England the maximum equity loan that buyers can currently access is 20%.

25. And we are supporting the broader housing supply through supporting work to establish a private sector mortgage indemnity scheme and a housebuilding infrastructure loan fund to unblock developments in the current economic climate which are stalled solely by a lack of funding for upfront enabling infrastructure. We say more about those areas below.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them?*

26. Given our strong commitment to social rented housing, grant support will account for the bulk of our funding to support increased housing supply, albeit at lower per unit levels than ever before. However, the drive to maximise the leverage achieved through our funding demands that we make use of other investment approaches, including guarantees, equity loans and other forms of loan arrangements.

27. As outlined earlier in this memorandum, the potential for using guarantees to lever in other investment has been demonstrated by our ground-breaking NHT initiative, and they feature in a couple of the complex Innovation bids which we are exploring further at the moment. Guarantees can be a less expensive option than more traditional grant-based approaches, but they also have a potential impact on resources and we do not consider them to be appropriate for every situation. The case for a Government guarantee must be demonstrated and evidenced on an individual basis.

28. In addition, the Scottish Government sees a limited role for alternative forms of investment in order to support activity in the owner occupied sector and wider housing market. We understand the need to take a systems-based approach to housing supply and we recognise that action to support private sector housebuilding not only supports economic recovery and growth, but can also help to unlock opportunities elsewhere in the system. Our investment in open market and new build shared equity products has, for example, resulted in approximately 1,285 households coming off the social housing waiting lists between 2005 and 2010 and around 1,130 social rented properties have been freed up across Scotland over the same period through the LIFT schemes.

29. In terms of supporting wider market activity, members of the Committee may be interested in the £10 million Housebuilding Infrastructure Loan Fund,[35] for which we recently launched a call for bids. The fund is intended to unlock the development of good house-building projects stalled solely as a consequence of a lack of development funding for enabling infrastructure. Repayable loans will be offered to successful applicants to

[35] http://www.scotland.gov.uk/Topics/Built-Environment/Housing/supply-demand/hilf

support the provision of on-site enabling physical infrastructure and other work genuinely required to commence house-building projects and thereby accelerate housebuilding in the current economic climate. Whilst the overall size of the fund is limited, we believe that it has the potential to lever in significant sums of additional funding, enable development which would not otherwise have occurred and thereby support Scotland's economic growth. We intend to evaluate this approach and than make an assessment based on that evaluation.

30. Finally, we believe that there is more that lenders could do to support first time buyers into the market, and have repeatedly called on the UK Government to do more to enable that to happen. With that in mind, we are also breaking new ground by providing loan funding to support the housebuilding industry body, Homes for Scotland, to develop a private sector mortgage indemnity scheme for new build housing in Scotland. Our funding will enable a scheme to be established, with the potential to subsequently unlock much higher volumes of lending to credit worthy borrowers where it is sensible and sustainable and consequently support new private sector supply.

*How could long-term private finance, especially from large financial institutions, be brought into the private and social rented sectors, and what the barriers are to that happening?*

31. We want to encourage growth of a high quality private rented sector (PRS) in Scotland that can help meet housing need and offer enhanced choice to households. To assist this, we are developing a new Strategy for the PRS. We plan to consult on our strategy early next year. This will be about existing housing and the encouragement of new supply.

32. Institutional investment in private rented housing has been low in Scotland. In part this is a feature of the position across the UK and reflects the UK's fiscal arrangements. It also reflects the highly fragmented nature of the sector and a lack of scale in terms of properties owned and managed by individual landlords, which militates against large scale investment by pension funds and other institutions. We welcome the recent change in the Stamp Duty Land Tax (SDLT) rules on bulk purchases so that the SDLT rate paid is now set based on the average purchase price of each property, rather than the total, combined purchase price. We hope this change will help to encourage large-scale investment in the PRS and expect to maintain this change if the proposals for the devolution of responsibility for SDLT in Scotland to the Scottish Parliament are agreed through the Scotland Bill. As renting becomes more popular, particularly with younger households, we will engage with potential investors to describe the dynamics of the housing market in Scotland and where opportunities exist for growth.

33. We are in discussions with a range of individual funds and providers of institutional investment to attract private investment into both housing and infrastructure, and we are seeking ways to align investors' interests with those of landlords. To the extent that such further innovations continue the drive towards increased outcomes, increased value for money, and lower or manageable Government risk, they offer us the chance to increase further our economic growth and the number of new affordable homes for families who need them throughout the country.

*How could housing associations and, potentially, ALMOs be enabled to increase the amount of private finance going into housing supply?*

34. Scottish Government believes it is necessary to identify which housing associations have the financial capacity to increase the amount of private finance through expansion of their stock and which do not. This targeted approach will avoid a situation where social landlords are being encouraged to take on greater debt when it is clearly not advisable to do so. There are no ALMOs operating in Scotland, but that principle would also hold for such a group of landlords if they existed here. However, attractive though it may be for government to encourage landlords to expand their activities, the final decision on whether to do so should be for the landlords themselves, in consultation with their tenants.

*How might reform of the council Housing Revenue Account system enable more funding to be made available for housing supply?*

35. We believe that the nature of the HRA subsidy system may have stifled performance incentives for many English local authorities and that its removal, after being in place for a generation, is to be warmly welcomed.

36. In Scotland, the finances of the 26 individual HRAs are independent of one another to the extent that any revenue surplus on an individual account can be flexibly re-invested in that local authority area either in existing stock, in new supply or to repay debt. This surplus amounted to an estimated £144 million in 2011–12 at Scottish level. In addition, any HRA receipts (Right-to-Buy and other property and land sales) can also be fully re-invested in the stock or in new supply or used to repay HRA debt at the discretion of each local authority. This figure, though much smaller than in recent years, was £61 million in 2011–12 and is also used to supplement council housing investment in new or existing stock or debt repayment in the area it is generated in.

37. To boost supply further, and thus build on these sources of investment, Scottish Government is offering grants of up to £30,000 per property to build new council houses. The HRA surplus working together with SG

grant can therefore help to boost the supply of council housing in the local area—and the greater the HRA surplus the greater, in theory, the supply boost.

38. As with all policies aimed at freeing up any system, however, HRA reform could have some unintended consequences. Our experience outside the HRA subsidy system, was that between 2003 and 2007, six Scottish local authorities out of 32 transferred their stock to Registered Social Landlords as their HRAs became unsustainable in terms of being able to invest sufficiently in the stock. A further four local authorities would have joined them in ceasing to be a landlord had tenants voted for stock transfer in these areas. Though we acknowledge many stock transfers also occurred in England from within the HRA subsidy system, the self-financing system, can only truly flourish in all areas if councils use their freedoms wisely and generate healthy HRA surpluses. This essentially needs to happen through careful cost control in relation to rents charged and through prudent investment and borrowing. In 2010–11, all 26 remaining HRAs in Scotland made some form of HRA surplus. However, a small group of them made very small surpluses which will not be able to be used to generate much, if any, additional investment in new supply. If the self-financing HRA system was working evenly across Scotland, all 26 HRAs would be generating very healthy surpluses for the greater benefit of their current and future tenants. So, moving to the new system, though positive, will probably not result in an even performance across the board unless all English authorities respond equally positively to their newly-formed incentives.

39. Despite these moderately cautious remarks, the Scottish Government believes English local authorities should optimistically look forward to the new system. Scottish Government wishes the newly reformed HRA system in England well and will watch its implementation with great interest taking on board any lessons we are think are relevant to Scotland.

*October 2011*

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**Written submission from the Resolution Foundation**

1. Individuals and families on low-to-middle incomes are falling through the gap in the housing market between home ownership and social housing. Historically high house prices, a tighter mortgage market and stagnating wages have left this group shut out of ownership for the medium to long-term. In 2010, it would have taken the average low-to-middle income household 31 years to accumulate a deposit for the average first home if they saved 5% of their income each year and had no access to the "bank of Mum and Dad". The picture looked a lot worse in London and a bit better in the North of England.

2. At the same time, cuts to government support for social housing will put further pressure on already long waiting lists, making it even less likely that working households will get access to council homes. This leaves many people on low-to-middle incomes stuck in a private rented sector that is poorly suited to providing a stable long-term home. In addition, an asset divide between those who own a home and those who rent long term is opening up.

3. A new approach to build-to-let development using institutional investment has the potential to be part of the solution to the housing needs of individuals and families on low-to-middle incomes who are unable to buy a home in the medium to long term. Attracting more institutional investment from pension funds and life insurance companies into the private rented sector would allow more rental accommodation to be built at a time when public funds are limited and the buy-to-let market is recovering only slowly. More importantly, it would support a shift in the type of rental product that the sector offers. Longer term contracts, higher quality, more consistent management and the ability to make home improvements would replicate some of the desirable features of home ownership for those who become long-term tenants.

4. The other important features of a new approach to build-to-let development are:

- The public sector invests its land for development rather than selling it upfront;
- Local Authorities take a more flexible approach to planning, balancing affordable housing requirements with the housing needs of working people;
- Investors retain an option to sell some rental units after a fixed period of time if necessary to secure competitive returns on investment; and
- Rented homes are managed at scale by professional landlords who can provide tenants with a high quality service at the same time as keeping management costs down.

5. Institutions were important investors in the private rented sector in the early twentieth century. But their role dwindled over time and currently only 1% of their overall investment in property is in the residential sector, much less than in other countries. This is, in part, because investment in the private rented sector has been perceived as less competitive than investment in alternative assets and investors have been concerned about the potential reputational risks related to tenant management. Previous government efforts to bring in institutional investment, such as the Private Residential Sector Initiative, have stumbled because they have not been able to guarantee adequate returns.

6. The new approach to build-to-let set out in this report could change that. Making it work will depend on close partnership between Local Authorities, institutional investors, developers and landlords with the flexibility

to renegotiate established approaches to addressing local housing needs. Investors will need to look again at their opportunities for investment in the residential sector rather than continuing to focus exclusively on the commercial property sector. In its forthcoming housing strategy, central government will need to give greater priority to build-to-let in the disposal of public land rather than focusing exclusively on homes for sale. For their part, Local Authorities will need to balance their ongoing commitments to housing the most vulnerable with a broader economic agenda for local growth and employment that depends on housing those on low-to-middle incomes in the private rented sector.

*November 2011*

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**Written submission from Dr Tim Leunig**

SUMMARY

— This submission argues that the nations' housing needs will be met when the planning system is liberalised, and known to be liberalised.

— At that point housing costs will fall, affordability will increase, and fewer people will be "priced-out".

— Once developers know that their land-banks are a depreciating asset, rather than an appreciating asset, they will build them out very quickly.

— Government financial support, in any shape or form, will raise housing costs in the medium term. It should be avoided.

IN DETAIL

(short answers to your specific questions follow at the end, but should be read in the context of this section)

In an economy in which everything is competitively supplied, and made up of things that are themselves competitively supplied, consumers will get a very good deal. However, not everything is competitively supplied, which means that monopoly suppliers of anything—talent, money, land—can "expropriate the economic rent".

For example, the production of televisions is broadly competitive. As the world gets better at producing televisions the biggest effect is that television prices fall. Workers and shareholders might gain slightly, but consumers gain most.

It is very different in football. If Sheffield Wednesday improve, win the FA Cup, get promoted twice, get into Europe win the Champions League and do really well financially, fans will not see prices fall. Nor will Milan Mandarić get rich. What will happen instead is that the players will get rich. That is how football works: top class footballers are near monopoly suppliers of top class football, and can "expropriate the economic rent".

Housing development requires land, labour—skilled and unskilled—and raw materials. Except in a handful of locations, none of these are in short supply. As such, housing should be like television. Sadly, one effect of the planning system is that land for development is in scarce supply, aggravated by being owned largely by a handful of developers. As such, landowners are able to "expropriate the economic rent"

This has a profound implication: broadly speaking any money that is put in to the sector by government will, sooner or later, simply filter through into higher land prices. Schemes to "get the industry moving", "help first-time buyers", and so on do nothing of the sort. All they do is inflate land prices, which generally makes it less likely that the industry will get moving, and certainly does not help first-time buyers.

We know that it costs around £100,000 to build a 1,000 square foot property. In some circumstances we would have to add an amount to clear the site (brown field development), or to provide utilities to the site (green field development). These rarely add more than £30,000 per house.

Clearly, if developers wrote down the value of their land to zero, they could make a profit of £10,000 by building houses, and offered them for between £110,000 and £140,000. We can be confident that in most parts of the country they would sell family houses at these prices as fast as they could build them. The reason the market has stalled is that developers hold land on their books at very high prices. The reason that they cannot find buyers at prices that make them money is that they overpaid for land.

In this context schemes that put government money into the industry make the situation worse, not better.

Developers are sitting on large land banks, including significant numbers of plots with planning permission. Workers and raw materials are available. Developers are not building because they take the view that the planning system is sclerotic, and that prices will rise in future. Genuine planning liberalisation, so the house prices would fall in future would lead developers to build houses as quickly as they could. In that context it would be better to sell now, rather than wait. Sitting on land would be a bad strategy for developers, just as sitting on steel is a bad strategy for Ford, or sitting on chips is a bad strategy for my local chip shop.

There are lots of ways to change the planning system. We could return to the pre-1947 town and country planning act system. In essence they said that anyone who owned land could build on it. There is no doubt that were we to do this we would get a very large number of houses built in the south-east. There are a lot of

people who own land who would be willing to see it built on. After all, agricultural land is worth £15,000 a hectare, and even taking into account the land that is needed for roads and other infrastructure, you can still build at least 20 houses to a hectare. A farmer could build houses for £130,000, sell them instantly for £150,000—far less than current prices—and make £19,000 after subtracting the agricultural value of the land. A profit of £380,000 per hectare will persuade a lot of farmers to build over their farms. If this happened, developers would know that prices would soon be falling to those sorts of levels, and would build out their existing planning permissions as quickly as they could: they would then be sitting on a depreciating asset. There are, of course, good reasons to oppose this approach: planning exists for a reason, and this approach could well lead to carbon-intensive American "exurbs".

An alternate approach is that put forward by Alex Morton at PolicyExchange. He has argued that far fewer people should have the right to oppose development. Broadly speaking if those who are immediately adjacent to the development can be won round, the rest of the community will not be permitted to stand in the way of development. Again, this is likely to lead to a huge increase in house building, which again means that developers will build out the permissions that they currently have before prices fall. Again, there are risks to sidelining the planning profession.

I proposed an approach in a 2007 CentreForum paper, *In my back yard: unlocking the planning system,* updated in my recently launched 2011 paper and *Community land auctions: working towards implementation*. This system is known as "land auctions". It is best thought of as a form of competitive tendering. When a local authority wants to buy chairs for the local school, it invites everyone who can supply chairs to name their price, and describe the chairs. The council then picks the best combination of price and quality—the "best value" chairs. The council gets a good deal, and the low price benefits local people by keeping taxes down.

Land auctions work the same way. The council states that it is willing to allow development, and invites people to offer their land for development, naming the price they want for it. All land that is not ineligible for development—sites of special scientific interest and the like—may be offered. The council then decides what should be developed, taking into account the suitability of the land, and the price that the landowner wants. The council grants planning permission on this land (this is the only way to get planning permission), and auctions it to developers, self builders, financial institutions and others, keeping the difference. I estimate that the council would receive about £45,000 per house in the south-east as a whole, and significantly higher than this in places where we are particularly in need of housing.

There are strengths and weaknesses of all of these approaches. By and large, the less democratic involvement there is, the more houses we will get, and the faster they will appear. That said, less democratic involvement means greater unpopularity, as people see the houses as being foisted on them. That is why I think community land auctions will work. They incorporate the legitimate concerns that people have about development, and which they should be able to express through the democratic process, into a system that will also deliver us more houses, because of the scale of incentives that are on offer to local communities.

Finally, a note on social housing. The reason Britain needs so much social housing is that market housing is very expensive. If market housing were cheaper, fewer people would need social housing in the first place. Furthermore, more people currently in social housing would choose to move out, freeing up social housing for those in need. We should never forget that more people in social housing would prefer to be owner occupiers then would like to remain as social tenants (the evidence is in John Hills report, Ends and Means). Finally, if market houses were cheaper, social housing would be cheaper to supply, not least because social housing landlords could simply buy market housing.

You set the following questions, which I now answer briefly

*How and where the more limited capital and revenue public subsidy can best be applied to provide the biggest return on the investment, in housing supply terms;*

— almost without exception government capital and revenue subsidies have positive effects only in the very short run. The long-run implication is simply to raise the cost of housing, and the cost of land. There is no gain whatsoever.

*What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them;*

— both of these are to be avoided wherever possible, as they both raise the cost of housing, and the cost of land. The government should never grant aid, lend or guarantee private house sales in any shape or form. The best way to increase the availability of social housing would be to release more land for development, so that market prices fall, as explained above. There is no need for further government money to achieve decent housing; on the contrary, we should be able to take at least £5 billion off the housing benefit bill within five to seven years without any restrictions on eligibility, by increasing the supply of market housing.

*What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening;*

— this is generally an even worse idea, since it is very hard to evaluate such schemes, and very hard to perform rigourous cost benefit analysis to find the real cost to the public purse, or the value provided.

*How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening;*

— long-term private finance will come into both the private and social rented sector when it is profitable. In the case of the private rented sector there is a widespread belief that "buy to let" is extremely profitable, although there is little evidence for this. As a result, we get a myriad of small landlords, who each make a "profit" in accountancy terms, that is, they cover their costs. But they do not make a profit in "economic terms", because they fail to cover the opportunity cost of the capital they invest, and the time they spend managing properties. Large financial institutions do not wish to compete with people who are willing to make very low profits. This tells us that the only way we are likely to see large financial organisations into the private rented sector is if rents rise relative to prices. That is not a desirable outcome. Private money will come into the social rented sector so long as the return is sufficient. Given that the government can borrow money at much lower rates in the private sector—particularly at the moment—it is not clear why we would want to borrow money from the private sector, rather than have government borrow it.

*How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply;*

— see previous question.

*How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply;*

— "reform" will not per se enable more funding to be made available, although clearly the winners will have more money that they can use to build more houses, while the losers will have less money and will be able to build fewer houses.

*How effective the Government's "Affordable Rent" proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term.*

— The move to "affordable rent" will allow social housing providers to pay more for property up front. As such, they will be better able to outcompete other people in the housing market. Thus we are likely to see a sustainable rise in the amount of social housing, at the expense of a fall in market housing. (This is in the context of the planning system constraining the total amount of property that is built). Thus the move to "affordable rent" will lead to more social housing, but less owner occupation and fewer private rented properties. It is not clear whether this is welfare enhancing. On the one hand we know the people in need of social housing are in real housing need, but on the other hand we also know that people in social housing would rather be in owner occupation, and the more generally social housing has relatively low rates of occupant satisfaction. Increasing the amount of social housing at the expense of private rented and owner occupied housing therefore has ambiguous welfare effects. Increasing all housing by reforming the planning system would be a much better idea.

About the Author

Tim Leunig is Chief Economist at the CentreForum think tank. He is the author of *In my back yard: unlocking the planning system* and *Community land auctions: working towards implementation*. He served on the academic advisory board to the Barker Review of Land Use Planning. He is also Reader in Economic History at the London School of Economics, and an affiliated member of the LSE's Spatial Economics Research Centre.

*December 2011*

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**Written submission from Hometrack**

1. Hometrack is a privately owned, independent property analytics business. Established in 1999 the business has built up a wide range of clients spanning the whole residential market from mortgage lenders to house builders, local authorities, housing associations and corporate investors. The business provides automated valuation and risk services to over 90% of UK mortgage lenders and has over 150 public sector clients.

2. This submission focuses on the results of recent analysis into the Right to Buy (RTB) proposals detailed in the Government consultation launched in December 2011. Specifically the capacity to release capital for re-investment in delivery of new affordable housing.

3. Hometrack carried out a similar impact analysis of the proposed Affordable Rent model in spring 2010, details of which could be made available to the Committee.

4. One of the sources of funding for the delivery of new housing comes from releasing the underlying value of an asset for re-investment. In the social rented sector security of tenure and rent restrictions result in a sizable discount to open market value.

5. Hometrack estimate that the unencumbered, open market value of the whole social rented sector (both Local Authority and Registered Provider stock) in England is over £400 billion, considerably higher than the book value.

6. There is a sizable arbitrage (difference) between existing use value and open market value which Right to Buy or other sales based policies can potentially release for re-investment in housing. On a regional basis this gap ranges from £75,000 to over £150,000 of "capital release" per property.

7. The challenge is how to extract this value for re-investment in a sustainable manner while retaining a decent supply of affordable homes to meet demand.

8. Hometrack's Right to Buy analysis used localised data on property prices and incomes to assess what level of discount would be needed to make RTB affordable for local authority tenants against key affordability criteria, primarily a 2.75 income mortgage multiple.

9. The findings show that the national average discount required to make RTB affordable to existing tenants would be 40% or £50,800—significantly higher than the average discount of 25%. In London the discount required to make RTB affordable is as high as 58% or £128,000. In the South East the figure is £75,000 (see figure 1).

10. While these figures show the discount to make RTB affordable the consultation announced by the Government on 22 December is to cap the discount at £50,000.

11. The Hometrack analysis shows that an estimated 65% of local authority tenants could afford to buy their home with a £50,000 discount. Across the country there is a wide regional variation and in London, where property prices are highest, only 12% of households could afford RTB with a maximum £50,000 discount (see figure 2 for regional breakdown).

12. The new discounts for RTB seeks to use the capital generated from each sale to re-invest in the delivery of a new home—a so-called one-for-one replacement. The Hometrack analysis shows that on a national basis the average capital raised per sale would be £64,725, much lower than the cost of delivering a new property and lower than the average RTB receipt of £77,470 under current policies. Figure 3 shows the average discount and capital released from each sale on a regional basis.

13. The analysis into the replacement rate of the Right to Buy proposals have been based on regional averages derived from the localised analysis.

14. The replacement costs for new housing have been based upon average values for re-let stock over 2010 to reflect a like-for-like replacement profile. For each new unit delivered there will be an element of self funding supported by the rental income. We assume housing providers will be able to borrow 70% of the capital value generated from the rental income ie if the replacement property generates £40,000 of capital value then we assume that this will enable funding for the first £28,000 of the replacement cost.

15. It is important to note that the analysis assumes replacement stock would be let at general needs rents rather than affordable rents which should deliver a slight higher capital value and improved replacement rate. Yet the assumed replacement costs are conservative and we would expect these two factors to broadly cancel each other out.

16. The capital generated from each RTB sale will be used to fund the difference between replacement cost and borrowings. Our analysis shows that to deliver one new home would require an average of 1.4 RTB sales. This ranges from a 1.1:1 rate in the North West to 1.6:1 in London—see figure 4.

17. The potential for RTB to deliver new funding for re-investment in new housing is clear. The greatest challenge is accurately assessing the propensity for tenants to take up the scheme and the availability and terms of mortgage finance. The vast majority of tenants are not in full-time employment which will have a major impact on likely take-up.

18. The Government has taken a cautious approach with its proposals. The aim will be to generate as much capital for re-investment with as few sales a possible to erode the stock of affordable housing. Targeting households on higher incomes in higher value areas will generate the greatest capital but these areas will also have high replacement costs. This raises the issue about the re-investment strategy for capital receipts.

19. The proposed £50,000 cap will impact on the likely take-up of the scheme. In Southern England where house prices are among the highest in the country, larger discounts are needed to make RTB affordable to tenants and this will limit take-up of the scheme.

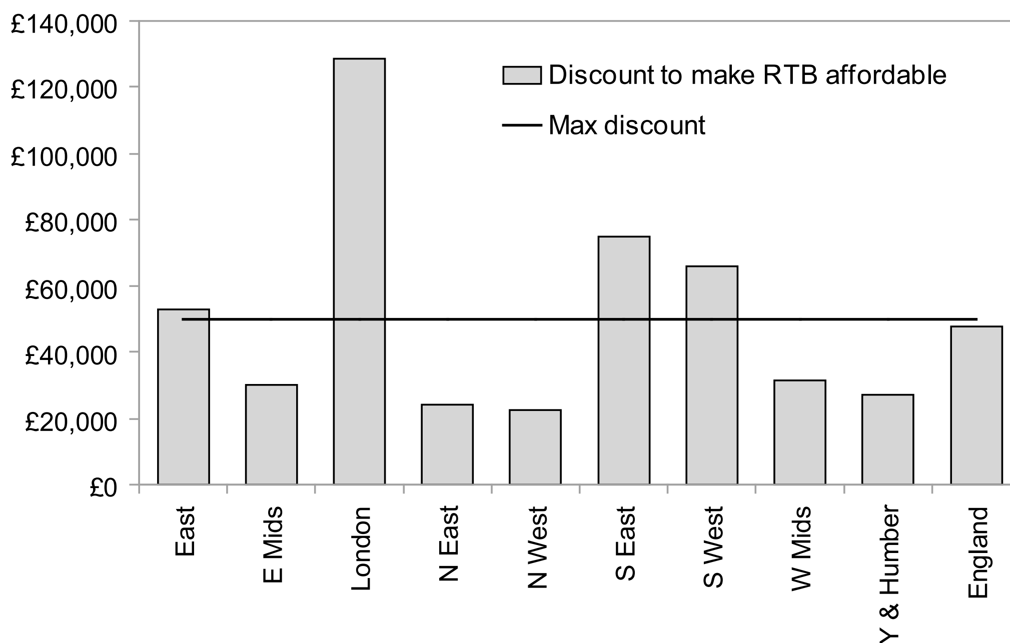
20. There is a careful balance to be struck between the discount and likely take-up. The £50,000 cap means that take-up is more likely to be in the most affordable areas of the country with a lower level of receipt per

sale than currently. This impacts on the ability to achieve a one-for-one replacement rate and it seems that extra subsidy in the form of development on low cost public land will play a vital role in meeting this policy objective.

21. The following charts set out the results of the analysis and are all sourced as Hometrack.

**Figure 1**

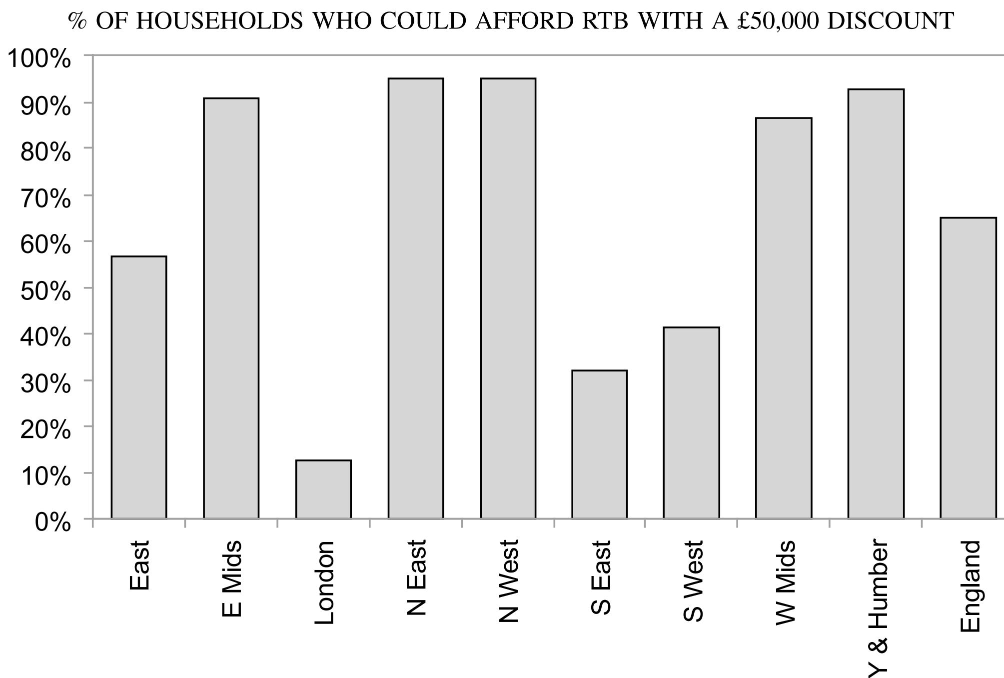
AVERAGE DISCOUNT REQUIRED TO MAKE RTB AFFORDABLE FOR TENANTS AND MAXIMUM PROPOSED DISCOUNT




*Source:* Hometrack

**Figure 2**

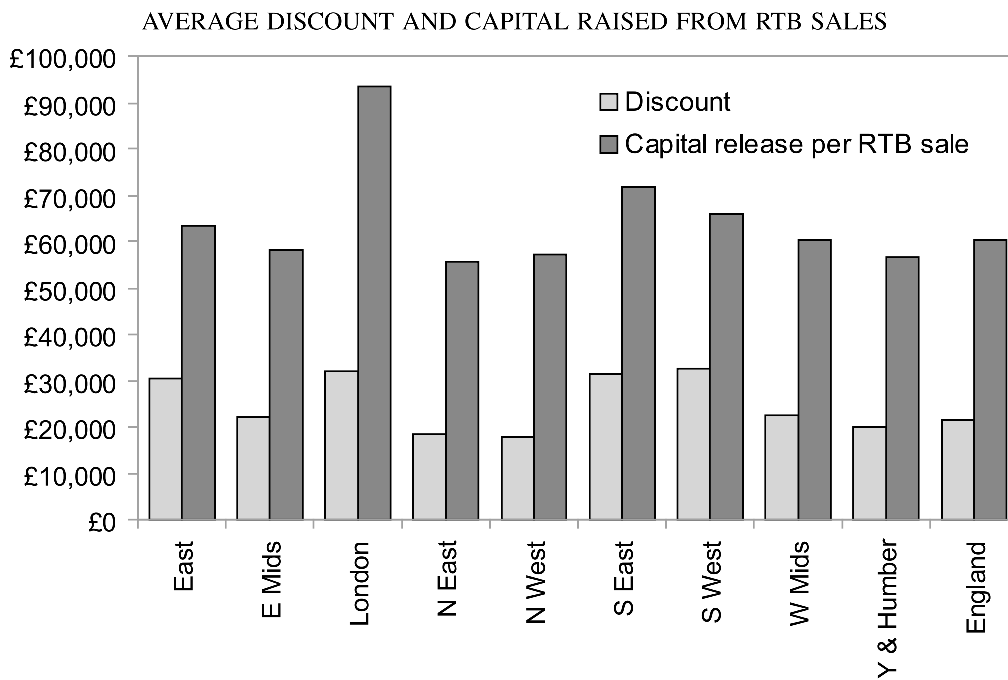
% OF HOUSEHOLDS WHO COULD AFFORD RTB WITH A £50,000 DISCOUNT




*Source:* Hometrack

**Figure 3**

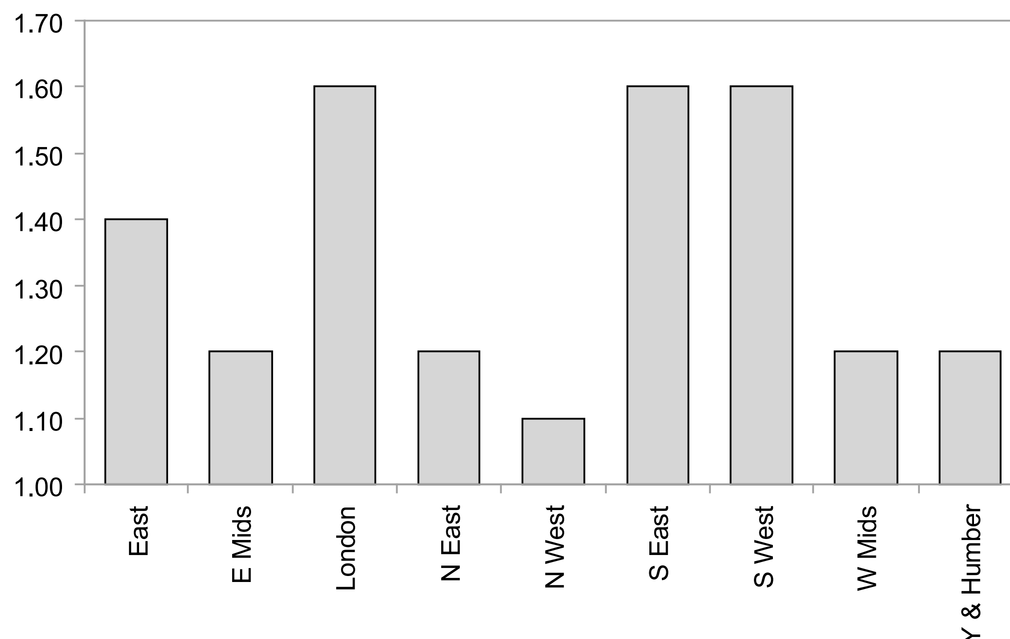
AVERAGE DISCOUNT AND CAPITAL RAISED FROM RTB SALES




*Source:* Hometrack

**Figure 4**

NO OF RTB SALES NEEDED TO DELIVER ONE NEW HOME WITH NO EXTRA SUBSIDY




*Source:* Hometrack

*January 2012*

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**Written submission from the Gentoo Group**

1.0 Introduction

1.1 Gentoo welcomes the opportunity to respond to the CLG consultation paper on Financing of New Housing Supply. The following response represents the views of Gentoo Group, which includes the following companies:

- Gentoo Group.
- Gentoo Sunderland.
- Gentoo Homes.
- Gentoo Construction.
- Gentoo Green.
- Gentoo Genie.

This response will primarily come from the point of view of the contribution that the Genie product could make to the financing of new housing supply.

2.0 Specific Responses

2.1 How long term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening.

Gentoo is well aware of the context of the current housing market. Even with a slow down in house price inflation, many potential buyers are effectively excluded from access to home ownership due to their inability to meet mortgage requirements—notably deposit levels that are often proving prohibitive without family or support from friends. It is difficult to foresee a short term remedy to this problem as banks continue to adjust their lending profiles within the context of deficit reduction and a struggling economy.

The problem of mismatch between supply and demand remains however and this is a latent problem that is building year on year. It is within that context that Gentoo has looked to develop innovative solutions that can look to address two concurrent problems: how to allow access on the part of the consumer to an otherwise prohibitive home ownership market and how to increase investment into the housing sector that is both viable and scalable.

The development of the Genie product addresses both of these issues.

The Genie is a new home ownership product with the accessibility of rental but the security of a mortgage purchase. It is based on a long term structured payment plan that allows the consumer to acquire a share of the property by paying a monthly residency fee.

This financial arrangement allows consumers to acquire shares in their home over time without the need for a mortgage or deposit. The target audience for the Genie is first time buyers and long term renters but as long as the customer meets the eligibility criteria, no one is excluded.

A simple worked example of how the Genie works is shown below:

| | |
|---|---|
| Property sales value | £125,000 |
| Initial monthly residency fee | £642 |
| Annual % increase in residency fee | 3% |
| Term of plan (months) | 300 |
| Administration fee (exc VAT) | £600 |

BASE TERMS EXCLUDING EFFECT OF OPTIONAL CONTRIBUTIONS WHICH MAY BE MADE DURING THE PLAN TERM

| *Contract periods: From Year* | *To Year* | *Annual rate of increase in Genie payments* | *Genie interest rate* | *Share of property acquired each year* | *Total share acquired in the period* |
|---|---|---|---|---|---|
| 1 | 5 | 3.0% | 6.0% | 3.5% | 17.5% |
| 6 | 10 | 3.0% | 6.0% | 3.7% | 18.5% |
| 11 | 15 | 3.0% | 6.0% | 4.0% | 20.0% |
| 16 | 20 | 3.0% | 6.0% | 4.5% | 22.5% |
| 21 | 25 | 3.0% | 6.0% | 5.1% | 21.5% |
| Total projected share at end of term | | | | | 100.0% |

(for illustrative purposes only)

On the basis of this example, first time buyers can then make an informed choice which is not based on access to either a deposit or a mortgage.

The Genie was launched in October 2011 following registration with the FSA. Since then we have generated the following interest:

- Portfolio now at 85 properties across the North East of England.
- 373 personal financial information statements issued since launch on 17 October.
- 76 applications received.
- 73% accepted at affordability in principle stage.
- 48% accepted at full application stage.
- 14 properties reserved.
- 10 properties completed and moved in before Christmas.
- Three bed linked and semi-detached properties are proving most popular with customers.
- Two bed properties are also popular.
- These properties demonstrate a greater yield and hence facilitate higher levels of ownership by the end of the term.

*Applicant statistics:*

- 87% are joint applications.
- 60% of all applicants are aged 20–29.
- 96% of applicants are employed.
- 91% of applicants have no existing mortgage.

As well as providing a much needed innovative access solution for consumers, the Genie also has significant potential to develop as an investment vehicle to attract large financial institutions. There are a number of advantages on offer:

Investment in the Genie Fund will have characteristics similar to investment in market rented housing but will essentially be more secure and stable because of the long term nature of the occupancy agreement and the increasing personal financial interest in the property of the occupier.

The Genie Fund will acquire housing at its market rent investment value, but will not carry the same liability for long term maintenance that would normally be associated with a market rent investment.

Whilst the fund will acquire property assets at their rental investment value (say 85% of the open market sales value) it progressively sells its interest to the occupier at full open market value on a pre-agreed basis,

thereby increasing its investment return without reliance on opportunistic sales on the open market normally associated with market rent investment appraisals.

The residency payment is at a premium above market rent, however it is more secure because the occupier accrues an equity interest which they may not be able to recover if they are in arrears or default under the residency agreement.

The residency fee increases annually over the full term of the agreement by a pre-agreed percentage (currently 3% per annum) which results in a payment that might broadly track long term inflation

In terms of barriers to this type of product developing, the real issue is to secure buy in to what is a new vehicle. Inevitably this will take a degree of explanation and persuasion but we have already done a lot of the leg work in terms of developing a viable product that meets the necessary regulatory ie FSA criteria. The real task now is to demonstrate the range of applications of this type of vehicle and its attractiveness against other investment models.

2.2 How housing associations, and potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply.

The application of Genie has further advantages for housing associations and ALMOs who are looking for alternative routes to attract private finance for housing supply. These include:

- Purchase of existing stock units to free up capital.
- Purchase of social housing voids from RSLs looking to diversify their stock and generate cash.
- Purchase of units in stalled developments to de-risk build-out.
- Commitment to purchase off-plan property.

The distribution of these advantages would accrue as the Genie investment fund develops. Thus, investors benefit from the long term surety of the sector but providers can also effectively look to the Genie investment fund as a source of future finance for the development of future homes that can be accessed through Genie. Early indications show that there is significant interest in the Genie product from housing associations who are looking to add to their portfolio of access and investment options.

Ultimately the major benefit to the sector and the increase in supply overall is that an investment fund is created that is scalable and viable. The aim is to attract large scale institutional investment which can then be used to increase housing supply on the basis of the inherent investment value within housing and the Genie model. The model would not be reliant on public funding nor would it require the management and maintenance infrastructure normally associated with affordable rented housing.

In short it is a private sector solution to a fundamental housing supply problem.

*January 2012*

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## Written evidence submitted by the Tenant Services Authority (TSA): the social housing regulator

1. Executive Summary

1.1 The social housing regulator has been asked to provide written evidence to the inquiry covering:

- 1.1.1 The impact of the Affordable Rent model on housing association capacity and financial stability, and tenant affordability
- 1.1.2 The role of historic grant, and the possibility of converting this to equity
- 1.1.3 The impact of the welfare reform agenda on housing association capacity and stability.

1.2 The economic regulation functions of the TSA, relevant to the subject matter of this inquiry, are continuing and will be delivered by a Regulation Committee of the Homes and Communities Agency (HCA) from April 2012.

1.3 The Private Registered Provider ("PRP" commonly referred to as Housing Association) sector came through the recent credit crunch and recession in good shape and remains financially stable with capacity for development.

1.4 Based on its review of Affordable Rent bids the social housing regulator is of the view that the current Affordable Rent programme should not of itself prejudice the viability of the sector or of individual providers, although participation in the scheme means that providers need to manage a broader range of risks effectively.

1.5 One of the key constraints on the future development of the Affordable Rent product beyond the current programme is the impact of gearing covenants in loan agreements. New forms of financing and constitutional structures that avoid problems with covenants are being developed but the situation needs careful monitoring. It is important the new solutions do not import unnecessary additional risk.

1.6 The social housing regulator is of the view that the possibility of converting grant to equity, as proposed by some providers, will not have a transformational effect on the capacity of the sector. It may give some

providers access to finance in the short—to medium—term but more work is required to understand the potential downside effects.

1.7 Welfare reforms are likely to introduce risks to the rental income stream of PRPs. It is too early to say what the full range of impacts will be but the initial view of the social housing regulator is that providers should be able to continue to meet the regulator's viability standard. However, changes may compound existing risks, and there will be a premium on providers managing their exposures effectively. Reforms may also reduce the financial capacity of PRPs, including to invest in new development. Risks would be compounded if lenders factored them into the price and/or longevity of future debt.

1.8 More generally, the current economic environment means that PRPs need more than ever to understand and manage risks to their business plans. Affordable Rent and welfare reform introduce specific risks that need to be managed alongside these broader risks and it is important that providers understand the cumulative impact of downside risk and not think about issues in isolation. The core business of economic regulation of the social housing sector is to work with providers to ensure these risks are being managed.

2. *Background: economic regulation, viability and capacity of the sector*

2.1 The Tenant Services Authority (TSA) is the independent regulator for social housing in England. Following the Government's review of social housing regulation, the TSA will be abolished and its economic regulation and a reactive consumer regulation function transferred to the HCA in April 2012. The TSA is currently consulting on its revised regulatory framework. In order to ensure the continued independence of regulation, these functions will be vested in a statutory committee within the HCA, legally separated from HCA's investment functions and with its membership appointed by the Secretary of State. The Chair of the Regulation Committee has been appointed.

2.2 The TSA's current economic regulation role, which will largely be carried forward into the HCA focuses on the financial viability and governance of PRPs. In the future the regulator will have an enhanced role in respect of the value for money of PRPs. This brief therefore concentrates on the capacity of these providers.

2.3 PRPs own around 2.5 million homes, with a gross book value of £101 billion and a significantly higher market value (commentators of the housing market have estimated a value of circa £300 billion). This is financed by £40.4 billion grant and £42.8 billion debt. Most of the debt is long-term and from banks. The sector has £12.4 billion undrawn facilities, although much of this is debt arranged to fund Large Scale Voluntary Transfer (historically transfer of council stock) business plans and so is not available for general development. This debt is off the public sector balance sheet as Housing Associations are independent organisations that take a variety of constitutional forms. The sector Global Accounts 2010 show surplus after tax in the sector of £609 million on a turnover of £12.3 billion.[36]

2.4 The sector has grown from 600,000 units in 1990 to 2.5 million units in 2011, mostly through a combination of stock transfer (c.800,000) and new development.

2.5 The sector has come through the credit crunch in good shape. There were significant issues—notably unsold low cost home ownership stock and cash/collateral exposure on interest rate swap deals, but these were successfully navigated through a combination of flexibility on grant, effective risk mitigation in PRPs and regulatory support.

2.6 No lender has ever had to enforce their security on a loan with a regulated provider. However, the banks who lent to the sector ahead of the credit crunch did so on generous terms and typically the loans are no longer economic for the banks. This is limiting the ability and willingness of the sector's traditional funders to continue to supply long term loans to social housing providers.

3. Affordable Rent

3.1 The traditional development model has involved units being funded by a combination of grant, debt and finance from other sources with grant contributing around half of the total. Units were typically offered at significantly lower than market levels, although the gap between social and market rents varies considerably between localities. In more recent years capacity has been augmented by planning gain (S106) contributions and some cross-subsidy from shared ownership and outright market sale.

3.2 Affordable Rent is a different model. Grant accounts for around 20% of the funding for new units. The capacity to service the debt on the rest of the costs of a new home comes from higher rents (up to 80% of market) on the new home, and the ability for providers to convert some existing units to a higher Affordable Rent, or possibly to dispose of some units, increasing debt-servicing capacity. In addition PRPs are still able to use the means of cross-subsidy referred to in paragraph 3.1 above.

3.3 TSA examined all Affordable Rent bids and advised the HCA on whether they were consistent with each bidding PRP's ongoing viability, one of the key requirements of the regulatory regime. All of the bids met this test, although in a few cases the regulator highlighted particular risks and exposures, which the HCA

[36] Source: 2010 Global Accounts for housing providers (TSA)

took into account when making allocations. The regulator is monitoring the PRPs concerned more closely as a result.

3.4 Over the longer term (most likely beyond the lifetime of the current programme) there may be issues to be managed with Affordable Rent as a model of new supply. Whilst the model, with its higher rents, does not create new problems with interest cover requirements (ie that providers have sufficient free cash to meet their interest payments), which is traditionally the key constraint on PRP finance, it does impact on gearing covenants where they exist in loan agreements. Gearing covenants in this sector are typically set with a ratio of debt to equity of 80% where equity is interpreted as grant plus surpluses. Over time participation in the programme will lead to higher gearing, and where gearing or similar covenants exist reduce borrowing headroom. Ultimately (beyond 2015) this is likely to mean some PRPs could need lender approval to take on more debt for development.

3.5 The potential need for lender approval because of gearing is a particular issue given that lenders are typically losing money on existing deals, which were priced at pre-credit crunch levels (c 30–50bps above LIBOR) with a borrowing term of 30 years. It is now common for new bank lending to be both at much higher margins (c 150–200 bps) and for the term to be five or at most 10 years. At the same time lenders are looking to reprice existing debt whenever an opportunity arises, eg if more finance is required or there is a change to the risk profile of the borrower through, for example, a new group structure.

3.6 The regulator is analysing the impact of this, which is not straightforward. Some associations are unconstrained by gearing covenants, for others covenants may prove a significant constraint by the end of this Spending Review period. Of itself this may not stop further development by those PRPs affected as there may be ways they can take on more debt without breaching covenants, although this could mean taking on risk in other parts of their businesses. The sector is already diversifying its sources of finance through bond issues but also other innovative ways of funding including private finance raised through institutional investors. In addition there is growing capacity in the LSVT sector, although because of typical covenant structures for LSVTs they will struggle to access this without having to look at potential repricing of existing debt.

3.7 Another important risk to the Affordable Rent model is the impact of its link to market rents, which may go down as well as up. The main impact of this for PRPs is that they need to more actively manage their exposure to rental markets.

3.8 The two points mentioned above indirectly relate to the issue of tenant affordability. Rent policy is largely a matter for DCLG. The regulator's standard on rents—and specifically the parts of the standard relating to Affordable Rent—is subject to a direction from the Secretary of State. The regulator has not looked directly at the affordability of future rents. It is however looking at the changes in terms of their impact on future viability, as per the above discussion and commentary that follows on changes to housing benefit.

3.9 Overall, at least at this point, risks to viability are manageable, and it is highly unlikely that Affordable Rent would of itself prejudice viability, although it could compound other viability risks. However, its impact in the longer term remains to be determined, but the need to raise more finance, combined with the reduction in traditional bank funding, is already causing providers to look at new and innovative financing proposals.

4. *The role of historic grant and the possibility of converting this to equity*

4.1 Grant reflects the subsidy needed to offer a unit at sub-market rent, and is in effect the price Government pays to secure a lower rent and a unit as part of the regulated sector. For the majority of the sector the balance sheet valuation of social housing assets is historic cost less grant.

4.2 Grant is obviously important to the financial position of PRPs: as set out above, grant is fundamental to the gearing of providers and forms a key part of their asset base. However, lenders typically value stock as security on other measures based on rental income (Existing Use Value or market value Subject To Tenancies).

4.3 The fundamental constraint on the sector is the availability of revenue (cash) to service debt. The writing off of historic grant would have no bearing on this, as it would not generate any additional cash flow. If it was in some way replaced by equity, unlike grant this would need to be serviced with a return for the investor.

4.4 The main reason some PRPs are interested in writing off grant and converting it to equity is to address gearing constraints highlighted above thereby potentially increasing the headroom to borrow more without revisiting existing loan agreements. Propositions that involve writing off grant to allow it to be converted to equity will *not* transform the sector's development capacity as a whole although a few individual providers *may* free up more capacity. They would also have as yet unknown consequences in terms of balance sheet valuations, which may not be positive. These propositions would also have wider ramifications—for example:

4.4.1 the system of recycling grant on sales plays an important part in funding new homes across the sector as a whole, which is facilitated by the regulator's role in granting consents to disposals (sales of properties outside of the sector).

4.4.2 There are legislative barriers to converting a not-for-profit PRP to a for-profit PRP, which may be relevant to these proposals.

4.4.3 PRPs would need to consider whether the costs of offering an equity return—which may be higher than conventional debt—outweigh the potential initial increase in capacity.

4.5 The regulator's current view is that more work is needed on equity conversions, and that there are a number of barriers and risks to address. If these are managed successfully, in certain circumstances equity may help unlock capacity. However, since the major constraint is still cash to service debt, this is unlikely to have a transformational effect.

5. *The impact of the welfare reform agenda on Housing Association capacity and stability.*

5.1 To date housing benefit has underwritten rent on social housing properties in full. Typically provider receive 53% of their total rental income from housing benefit (reflecting the general socio-economic characteristics of people who access social housing) much of which is paid directly to providers.[37]

5.2 The principal (though not only) changes to welfare that could affect the sector are:

5.2.1 reforms relating to levels of benefit paid where social housing is "under-occupied".

5.2.2 reforms capping benefits.

5.2.3 introduction of universal credit and the possible end of the system of direct payment of housing benefit to landlords

5.3 The impact of these measures in isolation, and together, is not yet clear, not least because not all the policy and practical issues are settled. In broad terms the ultimate risk to PRPs is a weakening of the relationship between rent and benefits leading to an increase in levels of non payment of rent.

5.4 It is very difficult to model the impacts on PRPs accurately, as much rests on assumptions about the behaviour of tenants and the ability of landlords to mitigate risks effectively (eg by putting in place measures to prevent arrears arising or dealing with cases swiftly if they do build up). There are also important geographic and other differences which means providers will be affected differently. In broad terms under-occupation changes could have a bigger impact in the North, whereas the impact of the benefit cap is more likely to be felt by PRPs in London, the South East and the East of England.

5.5 Initial work by the regulator suggests that welfare changes will not, of themselves, typically undermine the viability of PRPs, but will mean that PRPs will need to carefully manage their exposures. Welfare reforms do compound existing risks, and may be more problematic for some PRPs. Any loss of income would have to be managed by PRPs, and would typically lead to some combination of reduced development capacity, reduction or slippage to major repairs, or reduced community activities.

5.6 It is vital that risks to lender confidence as a result of welfare reform are managed effectively, given the sector's need to attract more debt, including in the region of £7 billion to finance the development of new Affordable Rent homes. Lender concern about future risks could affect the price and availability of future debt, which in turn would also erode the sector's financial capacity.

6. Concluding Comments

6.1 More generally as a result of the current economic environment but also as a result of the Affordable Rent programme and proposals on welfare reform, PRPs are facing an increased range of risks that they need to manage. One of the key roles of the social housing regulator's economic regulation function is to understand and engage with providers on their management of these risks. PRPs are exploring a range of solutions to enhance their capacity in the longer term but more work is required in the sector and with the regulator to understand the downside risks of these proposals.

*January 2012*

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## Written submission from the National Self Build Association

NaSBA is the main body that represents the interests of the £3.6 billion a year self/custom build sector. The organisation has a wide range of members—individual self builders, professional consultants active in the sector and a range of building products companies, builders merchants and specialist self built contractor/developer/enablers. We have been working with a team from the DCLG for the last year as part of a plan to significantly grow the number of self/custom built homes completed in the UK.

### Financing for Self Build Projects

1. There is a huge demand among the British public to have a home built for themselves. A survey conducted by the Building Societies Association in the autumn of 2011 suggested that 53% of the population would, at some stage in their lives, like to have a self/custom built home. Another survey, by one of the biggest lenders active in the self build sector (the Norwich and Peterborough Building Society) indicated that 30% of the population would like to undertake a self/custom build project in the next five years, and that 12% would (ideally) like to tackle a project over the coming 12 months. Based on the number of households there are in the UK that's about three million families who want to get a project off the ground in 2012.

[37] Source: English Housing Survey 2009–2010

2. This latent demand is borne out by other indicators too—typically four million people watch each episode of *Grand Designs*, more than 400,000 people searched for a building plot on *Rightmove* in September 2011, and over 100,000 people subscribe to the three main plot finding websites. The self build magazines are read by more than 100,000 people each month and there are eight exhibitions on self build every year, attended by around 200,000 people in total.

3. All this suggests there is a real desire among the British public to undertake a self/custom build project.

4. There are, however, two main problems to overcome, which is why only about 14,000 people currently manage to get a project off the ground each year.

5. *The biggest hurdle is finding a suitable building plot*. In parts of the UK there is reasonable availability (eg Northern Ireland, parts of Scotland and Wales), but in the more southerly parts of the UK, and in any of the urban areas, sites are very hard to find, and they are extremely expensive (compared to most other countries). The Government has recognised this and has taken action to help. For example the NPPF will require all local authorities to now assess the demand there is for self/custom build in their area, and then take suitable positive actions. And the Homes and Communities Agency is about to release five large sites for group self build opportunities that should deliver around 70 new homes.

6**.** *The next biggest challenge is getting finance*. There are two issues here—getting finance for an individual self build home; and getting finance for a group or community self build scheme. Mortgages are still available for individuals hoping to build their own homes, though typically the self builder will still need a sizeable deposit for the land and the construction cost (around 25% of the total is typical). While the Government and the major housebuilders have set up a scheme to make 95% mortgages available to new homes buyers, it seems unlikely that any such incentive will ever be practical to help one-off self builders.

7. For groups of people trying to get a community self build project off the ground for—say 10–15 families—getting finance to buy a site so they can split it up into individual plots is very difficult. Inevitably the people will all have different financial circumstances, and few of them will have lots of ready cash available. When groups of people have done this in the past they have either been blessed with access to a wealthy benefactor, or the land cost has been very low in the first place. The new £30 million Revolving Fund that was announced by the Housing Minister in the autumn will help groups like this, as they should be able to qualify for a set amount of money that would then enable them to bid for sites (against the more nimble land buyers from the major housebuilders).

8. For small builders, who are expected to be very important providers of serviced self build plots in the future, getting finance from the conventional banks is currently very difficult. We know of many builder/developers who can't get loans; and those that have been offered finance, can only access it at very high interest rates and with exorbitant arrangement fees. For example, a builder seeking £200,000 to buy a site that could be split into four plots for self builders, was offered the cash from a bank, but we have been told the total cost was almost another £100,000. This made the whole scheme non viable.

9. We know your Committee has visited Almere and you were impressed by the self build project you saw there. We would welcome similar projects to this being set up in and around the UK. This will require a mind-shift from some people in the planning world, but we think the idea of a very "light touch" planning regime has much to commend it.

10. The biggest challenge with a project like Almere is finding a local authority with the vision and enterprise to give it a go.

11. The other key to the success is the initial land cost; it has to be acquired at something like agricultural values initially. The council then has to invest in the infrastructure—roads, utilities etc—and this usually adds at least £10,000 per plot provided.

12. At Almere land is sold by the square metre to would-be self builders; so those on tight budgets wanting only a modest home might buy just 100 sq m, and build a two or three storey house on it to give them a 80–100 sq m (two/three bed) home. The land at Almere is sold to self builders at about £290 per sq m, so a 100 sq m plot costs them £29,000. With typical build costs of about £1,000 per sq metre, you can therefore buy a site and build a three bedroom home for about £130–150,000.

13. In the UK similar building plots would be at least two to three times as expensive as they are in Almere—if not more.

14. If projects like this are to be set up in the UK we are confident there would be huge demand, as they save the average home buyer about £50,000 per home. *And* they get the home they really want, rather than an off-the-shelf solution that's been built as cost effectively/cheaply as possible by a volume housebuilder.

15. In Germany and France nearly every council provides a steady stream of affordable building plots for its residents. Typically the land is acquired by the council at modest cost, the infrastructure is put in, and the plots are then made available to people at reasonable prices. Sometimes some of the plots are reserved for people in key occupations or locals that have lived in the area for many years, and are offered at a reduced rate (with larger plots sold at a premium to help cover this).

16. That's why self/custom build is such a mainstream way of providing housing in continental Europe. We'd like to see the same happen here.

17. We don't believe there's any need for a subsidy—councils should recover all their costs in land acquisition and putting in the infrastructure. Indeed they might even be able to make a modest profit.

18. And if the plots are readily available at reasonable prices—typically they are available at about £50,000 each in most of Germany and France—hundreds of thousands of people in the UK would be able to get their dream self/custom build home underway.

*February 2012*

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**Written submission from the Chartered Institute of Public Finance and Accountancy (CIPFA)**

*This submission has been prepared by Alison Scott and Lesley Lodge* on behalf of the Chartered Institute of Public Finance and Accountancy.

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise exclusively in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

1. Summary

1.1 In CIPFA's view, substantial investment in housing is urgently needed to sustain decent homes and to build new ones—this could relieve the pressure for affordable housing and contribute towards boosting the economy. This submission addresses two potential approaches that could support delivery of these aims:

1. Local authority guarantees (in particular mortgage guarantees).
2. Local authority borrowing for council housing.

1.2 *Guarantees* fall within two categories—financial instrument guarantees and other guarantees (ie any guarantee that is not a financial instrument guarantee, for example guaranteeing levels of service delivery). Financial instrument guarantees are those where the person or organisation giving the guarantee assumes responsibility for a debt if the original debtor is unable to make the due payments. In summary, guarantees other than financial instrument guarantees are treated as provisions, and therefore will be recognised as expenditure (and a liability) when it is more likely than not that the giver of the guarantee will be required to make a payment under the guarantee.

1.3 *A cap on local authority borrowing for housing* will be introduced with the implementation of the Self-Financing system on 1 April. In CIPFA's view, the cap is both a potentially significant hindrance to the much-needed investment in council housing and unnecessary as borrowing by local authorities is already restricted to manageable levels by the Prudential Code.

2. Local Authority Guarantees (in Particular Mortgage Guarantees)

*Accounting for Guarantees—general*

2.1 Guarantees fall within two categories—financial instrument guarantees and other guarantees (ie any guarantee that is not a financial instrument guarantee, for example guaranteeing levels of service delivery). Financial instrument guarantees are those where the person or organisation giving the guarantee assumes responsibility for a debt if the original debtor is unable to make the due payments.

2.2 In summary, guarantees other than financial instrument guarantees are treated as provisions, and therefore will be recognised as expenditure (and a liability) when it is more likely than not that the giver of the guarantee will be required to make a payment under the guarantee. Although this type of guarantee is unlikely to be relevant to mortgage guarantees, it would be relevant if a third party (for example a charity or housing association) were building new homes and a local authority had provided a guarantee that the building would meet certain standards. Financial instrument guarantees, which would include mortgage guarantees, are accounted for under the financial instrument standards.

2.3 These are measured (valued) at fair value. Where the guarantees are given for a premium (fee), especially in an open market situation, fair value is initially the purchase price. A liability for the guarantee is recognised on the balance sheet, matched by the cash received for the premium. Profit or loss will be recognised subsequently in the income and expenditure account depending on whether the call on the guarantee is less than or more than the price.

2.4 Where no premium is paid, as is often the case when local authorities are giving guarantees for policy or service reasons (eg to enable a voluntary organisation to deliver a service), valuation techniques need to be used. The most common technique is to assess the probability of various levels of loss, and value the guarantee at the probability weighted average loss. If the other party could have obtained a guarantee elsewhere, the price they would have had to pay could also be used as the fair value. Again, a liability for the guarantee is recognised on the balance sheet. As no premium will have been received, this is treated as an immediate cost within the income and expenditure account, and subsequently adjusted as losses become more or less likely.

*Mortgage Guarantees*

2.5 CIPFA is not aware of authorities giving mortgage guarantees for HRA properties, as the authority is able to act as a mortgagor of last resort.

2.6 CIPFA understands that some authorities are considering involvement with a "Local Authority Mortgage Guarantee Scheme." The Scheme involves the provision of financial assistance from a local authority to first-time home buyers who can afford to make mortgage repayments but cannot afford the larger deposits required to secure a maximum mortgage typically offered by most mortgage lenders of 75% loan to value. We also understand that it relates to the purchase of private sector housing and does not cover, for example, local authority Right to Buy, Self Build dwellings or new builds. Because the Scheme covers private sector housing rather than Right to Buy properties accounting entries will relate to an authority's General Fund rather than its Housing Revenue Account.

2.7 Our understanding is that the Scheme requires a local authority to provide an indemnity to a participating mortgage lender, on behalf of a mortgagee, of up to 20% of the value of the property. This will require a smaller deposit to be made by the home buyer (to a level of 5%). This would enable the mortgagee to obtain, using the example of 5%, a 95% mortgage on similar terms to a 75% mortgage.

2.8 CIPFA has not had sight of the legal agreements under which the Scheme operates. However, our understanding is that there are two models that can be followed:

*Unfunded model*

2.9 The unfunded model operates as a financial instrument guarantee, as described above. A premium may be charged for the award of the guarantee. Authorities will need to determine whether this amounts to the fair value of the guarantee, in which case the accounting treatment is as set out above, or whether they are providing a guarantee at below market rates. If the latter is the case, valuation techniques (as described above) would be used to determine the fair value of the guarantee, and the difference between this value and the premium received would be treated as an immediate cost in the income and expenditure account.

*Cash Backed Model*

2.10 Under this model, the Local Authority invests with the participating lender for the full value of the indemnity being offered (up to 20% of the property cost). Interest is received on this investment.

2.11 The accounting treatment for this model appears to be covered by Regulation 25(1) (b) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003 No 3146) (as amended), although CIPFA has not taken legal advice on this issue. This regulation requires that "a loan; grant or other financial assistance to any person, whether for use by that person or by a third party, towards expenditure which would, if incurred by the authority…" is treated as capital expenditure.

2.12 The payment to the lender would be included in the balance sheet, and would be treated as capital expenditure. Unless this was funded from capital receipts or grants, this would increase an authority's Capital Financing Requirement, and consideration would need to be given to meeting the requirement for prudent Minimum Revenue Provision charges in accordance with the statutory guidance. Interest received would be treated as income in the income and expenditure account. When the principal amount of the investment was repaid, this would be treated as a capital receipt, and CIPFA would expect authorities to use this to reduce the Capital Financing Requirement, although there would be no legal obligation to do so. Where calls on the deposit were made, the amount returned to the council would be reduced, and this might leave the authority with a balance to be funded.

2.13 If it subsequently emerges that the Scheme is not covered by the regulation, the investment with the participating lender would be accounted for as a financial asset.

3. Local Authority Borrowing for Housing

3.1 The implementation of Self-Financing, the new system of financing for council housing, will introduce a cap on local authority borrowing for housing from 1 April. However, substantial investment in council housing is urgently needed to sustain decent homes and to build new ones. This could also relieve the pressure for affordable housing and contribute towards boosting the economy. It is estimated that, with social housing grant, councils could build an extra 100,000 homes in the next five years, if released from the restriction of the cap and that even without grant, they could build some 50,000 new homes.

3.2 CIPFA has long considered that such a cap is totally unnecessary because the introduction of Prudential Code has clearly proved that Local Authorities can be trusted to act prudently with regard to borrowing. Under prudential borrowing, a local authority must only borrow when and if the debt repayments and interest are affordable. Affordability is crucial and therefore aggregate borrowing should never reach unaffordable levels. The cost and availability of loans in itself provides the commercial discipline, obviating any need for regulation.

3.3 The building of new homes would also generate additional rental income that could be used to meet the increased costs of borrowing.

3.4 When it was introduced in 2004, prudential borrowing marked a major shift in how local authority capital spending was controlled. The previous prescriptive central controls were swept away and instead councils were given responsibility to make their own decisions and manage their own affairs. We believe that local authorities rose to that challenge. Borrowing since 2004 has been both prudent and modest, and focused on financing spending that delivers savings or service improvements. Capital spending has been better linked to business objectives and better value for money has been realised with the ending of the perverse incentives in the earlier system—for example to take on leases when purchase was clearly more economic.

3.5 Currently, local authority borrowing for council housing is around £7,000 per unit—less than half that of housing associations—and will be restricted under the cap to the level that applies in each authority at the time of implementation. However councils could borrow more than this and still stay within the agreed borrowing rules under the prudential borrowing framework. In CIPFA's view, such necessary local authority borrowing can be properly and prudently financed and used to meet urgent housing needs.

3.6 Throughout the period since 2004, the Treasury has never had to use its reserve powers to intervene in these borrowing arrangements—and the costs of central oversight and control have been reduced. There are broader lessons too. Councils can be trusted to manage complex finances on behalf of their local communities. Localism is a good model for ensuring joined-up decision making, efficient outcomes and economic growth.

3.7 CIPFA believes the prudential borrowing framework has worked very well. We would urge the Government to retain the full flexibilities of these arrangements and not to press ahead with the introduction of a cap on housing borrowing.

4. CIPFA would be happy to provide further information on any aspects of this response.

*February 2012*

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## Written submission from Igloo Regeneration

### 1.0 Igloo Regeneration

In response to the request from the select committee, this paper is provided by igloo regeneration, the development manager of Aviva's igloo regeneration fund (www.igloo.uk.net), described by the United Nations as the world's first responsible real estate fund. Igloo's expertise is in the funding and delivery of physical regeneration.

The Local Developers Forum is an informal group of small volume residential developers who mainly operate in their local areas. The Forum was formed in response to concerns about the discriminatory impact of the implementation of NewBuy on small developers.

This concern is best encapsulated by the following quotes from Forum participants describing the scheme as:

- "fundamentally unfair against the previously outlined principles of the scheme being open to small residential developers"; and
- "it seems extremely unfair that smaller housebuilders are left to try and catch up with the process at the end while the bigger ones get a head start".

However the Forum strongly supports the principle of the NewBuy scheme.

### 2.0 Summary

- Around a third of homes are built by builders who build less than 50 units per annum in the current market.
- Nearly half of homes are built by builders producing less than 200 units per annum.
- There are around 18,000 small builders in the UK.
- The Government has not made available to small builders detailed information on the NewBuy scheme that it is developing with the Home Builders Federation, Council for Mortgage Lenders and Jardine Lloyd Thompson.
- However the Scottish Government is developing an almost identical scheme with the same manager (JLT) and this information has been made available.
- The NewBuy scheme discriminates against small builders by setting a minimum cell size and by having a number of non volume related costs.

- In addition, in the process of creating the scheme, the Government has discriminated against small builders in England by not making information available (a number of large builders are already marketing the scheme) and by promoting a list of builders on its website as being involved in the scheme and not adding further names as builders expressed interest in the scheme.
- There are potential solutions to these problems including:
  (1) Price the NewBuy scheme so that all costs are on a per home basis rather than fixed amounts.
  (2) Remove the minimum cell size requirement.
  (3) Ensure that small local developers are able to launch the scheme at the same time as their larger competitors by ensuring that the scheme cannot start until all participants have had a reasonable period from receipt of information to complete all the necessary requirements for making it operational in their businesses.
  (4) Remove the list of developers from the Government web site or continually update the list with the names of those developers expressing support for the NewBuy scheme.

### 3.0 Introduction

3.1 The Government has announced that it will be providing a guarantee as part of a mortgage indemnity guarantee scheme (now called NewBuy) which will reduce deposit requirements for mortgages on new build homes from a current average of around 20% to 5%.

The Local Developers Forum supports this excellent and innovative initiative but is concerned that the implementation will discriminate against small volume builders.

3.2 This evidence is based on information provided to developers in Scotland by the Scottish Government. The Scottish scheme (Mi-Home) is being developed by JLT in parallel with the scheme in England and has the same characteristics as those announced by the Government for NewBuy and some of the Scottish information seems to be written to apply to England. We have therefore assumed that the Scottish scheme information is likely to apply in England.

We have however been unable to confirm this as the Government has not been prepared to provide detailed information on NewBuy.

3.3 Based on a variety of sources (NHBC, Office of Fair Trading, Housing Market Intelligence report, HBF) we calculate that currently around a third of homes are built by builders who build less than 50 units per annum in the current market and nearly half of homes are built by builders producing less than 200 units per annum.

3.4 There are around 18,000 small builders in the UK.

### 4.0 NewBuy Issues

4.1 The scheme is structured so that each builder will set up a "cell" with each lender providing mortgages on that builder's projects. Within these cells the default risk on the mortgages is pooled. These cells are likely to have a minimum requirement of 100 mortgages per cell over a three year period. Each builder is likely to need relationships with a minimum of three lenders (because this is likely to be a requirement of the scheme and because lenders often have per project lending limits and to maintain competition—in practice it is likely to be a larger number).

4.2 This means that to set up cells on its own a builder will need to be building an absolute minimum volume of 100 units per annum. This is likely to exclude around 40% of builders.

4.3 The Government proposed solution to this is to allow small builders to share with each other. This is likely to be more complicated to set up, to take a longer period of time and means that builders are sharing risks and returns with their competitors.

4.4 There are a number of fixed costs involved in joining the scheme and in setting up cells. These are not likely to be fully related to volume and therefore give an advantage to large volume producers.

### 5.0 Lack of Transparency in Set Up Process

5.1 The Government has also been discriminating against small local builders by not being transparent about the negotiations (in contrast with the parallel discussions in Scotland which is where our information comes from) and by promoting certain of the participants on their website.

5.2 This discrimination is evidenced by doing a Google search for NewBuy which produces paid for advertisements by Taylor Wimpey and Barrett who are both named on the Government website.

6.0 Possible Solutions

There are a number of possible solutions to this discrimination that could be introduced before the scheme is launched including:

(1) Price the NewBuy scheme so that all costs are on a per home basis rather than fixed amounts.

(2) Remove the minimum cell size requirement.

(3) Ensure that small local developers are able to launch the scheme at the same time as their larger competitors by ensuring that the scheme cannot start until all participants have had a reasonable period from receipt of information to complete all the necessary requirements for making it operational in their businesses.

(4) Remove the list of developers from the Government web site or continually update the list with the names of those developers expressing support for the NewBuy scheme.

7.0 Conclusion

The Local Developers Forum represents builders who are closely connected with their local communities and who are providing the homes that those communities need.

We support the aims of the NewBuy scheme and congratulate the government on supporting it.

However we believe it is fundamental unjust for public money to be used to discriminate against small and medium sized businesses.

This seems to fly in the face of Government expressed support for localism and for small and medium sized enterprise.

*February 2012*

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## Written submission from BuildStore Financial Services

Summary

Consumer interest in self build housing in the UK appears to be growing. BuildStore's data suggests that between since 2009, demand for private self build finance had grown by over 30% in the UK and its land database, PlotSearch, has a register in excess of 80,000 people looking for building plots and properties for renovation and conversion.

Key reported market drivers for this demand include:

— a lack of affordable and suitable "new build" market homes (especially since recession & collapse of speculative house building market);

— an increased availability of plots (particularly in depressed markets);

— the drive to greener and energy efficient living; and

— the effects of the media and increased marketing.

The appeal of self build is the ability to design and create a home that suits their needs, very often for less than they would pay on the open market. As well as an opportunity to create a customised home, financial gains are also an important factor. Self builders can secure an in-built equity in the new property, typically achieving typically 25%–30% more value in the property than the total cost of the development. Self builders also pay a much smaller Stamp Duty bill, and do not pay VAT on their materials.

The result is that since its emergence in the 1970s, the UK self build sector has become an identifiable marketplace, with its own dedicated businesses, supply chain, media outlets, representative associations, brokers and mortgage products.

However, there are some important challenges holding back the growth of the UK self build industry.

Key obstacles uncovered (which are also affecting the wider house building industry), include:

— availability of (self build) development finance;

— availability of suitable land in sought-after locations;

— disproportionate planning regulations; and

— Lack of support from industry.

Self Build's contribution to the housing market should not be ignored, particularly in light of the collapse of the dominant volume housebuilding market, and recent commitment from Government to support and grow the sector, through a range of policy and regulation changes. If the potential of the market is to be realised—the aspirant market is thought to be as high as 100,000—these obstacles need to be addressed, particularly in relation to finance and land availability.

(1) *Self Build's contribution to housing supply*

While self build housing has never been seen as a volume option for housing procurement, it has provided a steady supply of quality homes year on year. The advances in the market, coupled with Government support and political reform means that there is now a greater likelihood that the self build sector will grow and become a mainstream contributor to the housing market.

### Market Size

When The Joseph Rowntree Foundation commissioned the "Barlow" report on the self build market in 2001—"*Homes to DIY For*", it was estimated that the size of the self build market in 1999 was around 15,000 units, and worth over £2 billion.

It concluded that the self build market could be grown to more than 20,000 units annually, but in order to overcome the barriers, the industry would need to be overhauled and modernised through reforming land supply, planning policy and finance. The report also highlighted the need for "stronger intermediaries" or "system integrators", to act as a go-between for self builders and industry suppliers, including land, finance, labour and materials.

In the years after the Report, the self build market peaked around 2006–07, reaching 17,000 completed homes, including major renovation and conversion projects).

The onset of the credit crunch in 2008 and recession through 2009 and into 2010 hampered self build, and annual output levels dropped below 10,000 units.

In 2010 and 2011, the market has made a slow recovery, with a total of 11,000 self build homes completed in 2011, according to data released by *Homebuilding & Renovating* in its Self Build Market report in December 2011.

### Demand and Potential Market Size

Despite a lack of official records, we have been able to acquire reasonably realistic snapshot of current demand, using BuildStore's PlotSearch online land database.

There is proportionally a larger number of subscribers to this database (over 80,000), based on the perceived size of the self market, and these subscribers are regularly polled. We have also been able to analyse ore broadly the way our database is used and searched to identify trends and illustrate demand.

PlotSearch is the largest online land database in the UK, with over 8,500 building opportunities, which includes plots, renovation properties and conversion projects.

Research carried out in August 2011 examined the number of plots available in various geographic areas, set against the number of people searching for land in those areas. Our findings show that demand outstrips supply across the whole country. In the South East for example, we see that for every available plot, there are 20 people searching. In London, that rises to one plot for every 100 people searching.

The table below shows the ratio of plots to people searching in each UK region:

| *Region* | *Ratio of Plots to Persons Searching* |
|---|---|
| London | 0.01 |
| South East | 0.05 |
| South West | 0.11 |
| West Midlands | 0.13 |
| East | 0.18 |
| North West | 0.18 |
| North East | 0.29 |
| East Midlands | 0.32 |
| Yorkshire | 0.40 |
| Scotland | 0.75 |
| Wales | 0.80 |
| Northern Ireland | 7.48 |

The distribution of searches conducted in the six months to August 2011 show that the South East is the most popular region, closely followed by the South West.

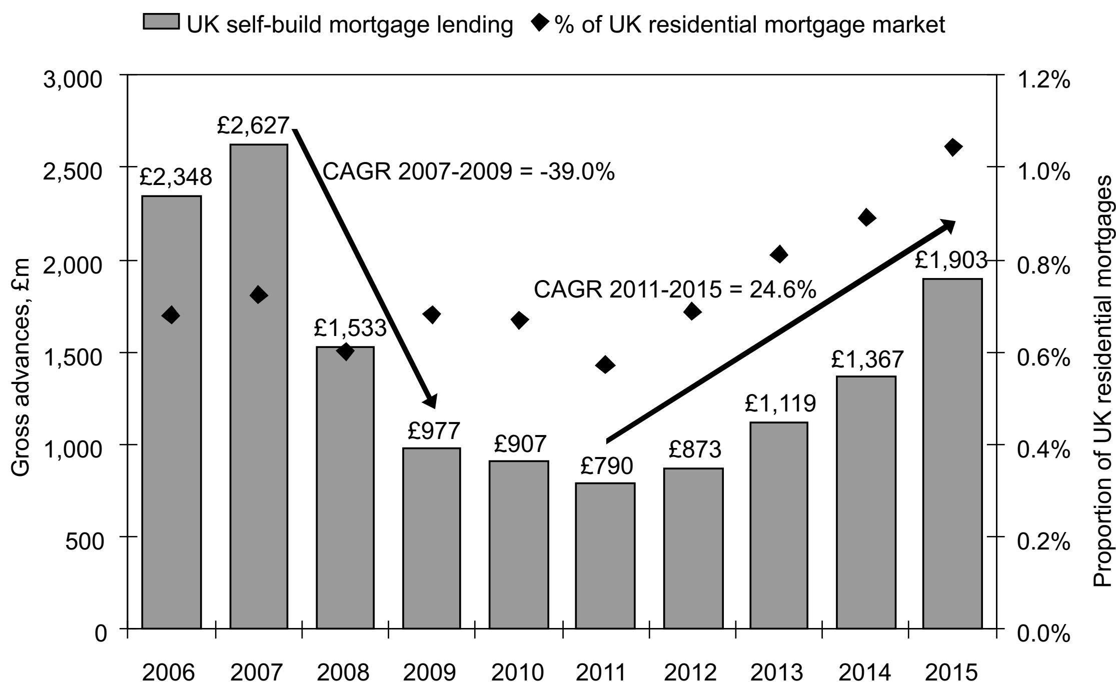
| *Region* | *Percentage of All Searches* |
|---|---|
| South East | 20.32% |
| South West | 19.43% |
| Scotland | 13.20% |
| East | 11.91% |
| West Midlands | 8.63% |

| *Region* | *Percentage of All Searches* |
|---|---|
| Wales | 6.41% |
| East Midlands | 5.89% |
| North West | 5.47% |
| Yorkshire & the Humber | 4.25% |
| North East | 2.34% |
| London | 1.53% |
| Northern Ireland | 0.62% |

What is not shown by these figures is that the location of plots is a major factor, and lack of availability of plots in sought-after areas and conurbations is an overriding issue throughout the country. Scotland is prime example of this. It is the third most popular search area, but the location of plots are not in the areas where people want to live—a large proportion of them are in isolated rural spots in the far North, rather than across the central belt, close to where people currently live and work. This trend is common in all areas in the UK, where there are disproportionately fewer plots in major towns, cities and built up areas.

Demand for self build finance has also continued to grow year on year, and both mortgage enquiries and mortgage completions throughout 2011 were up on 2010, by 16% and 15% respectively. With enquiry levels demonstrating enough demand to require over £1.2 billion of extra lending, there is a case to increase the availability of mortgage finance for self builders.

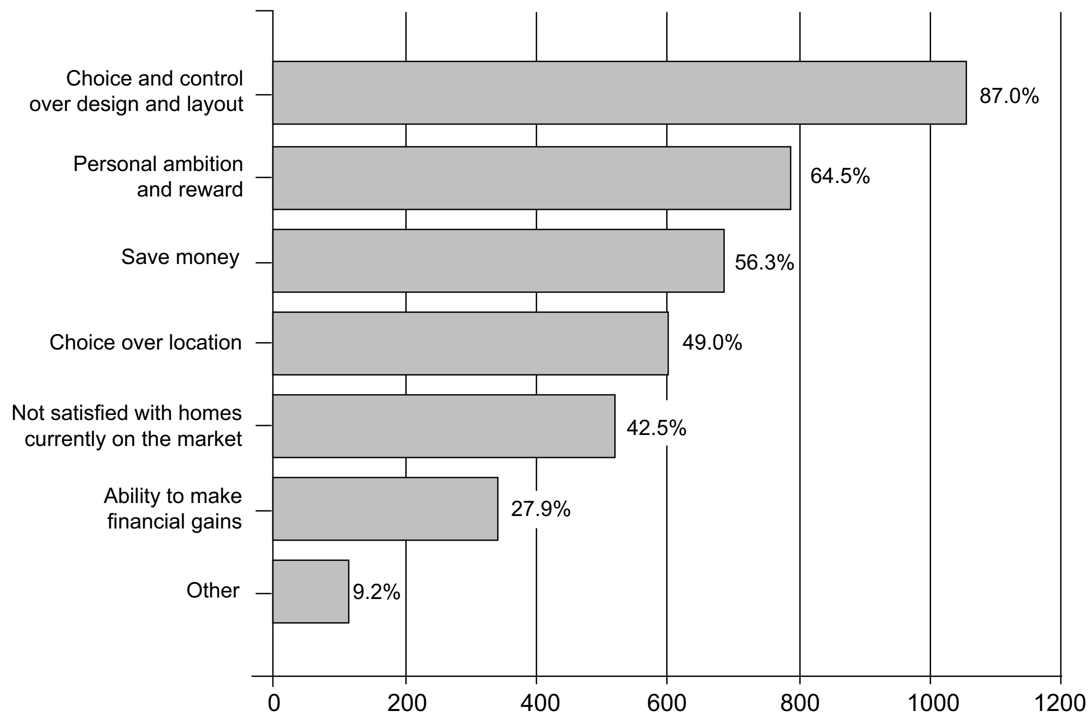
The latest Datamonitor *UK Mortgage Map* predicts that the sector will double in size over the next three years to reach annual gross lending of £1.9 billion by 2015 and will take share from the overall mortgage market:




MOTIVATORS

There are number of reasons why people choose to build their own homes. Typically, the initial motivator is a change of lifestyle, which dictates for example, re-location, down-sizing to smaller property, or upgrading to a larger property.

However, the motivation for self build in these circumstances usually stem from a dissatisfaction with properties on the open market; the option to design and specify a property that suits their requirements and lifestyle; and the ability to save money and make financial gains.




## Quality of Homes

Self builders provide a significant portion of the detached housing stock in this country—around one third of all new detached homes.

Furthermore, because they are not motivated purely by profit, self builders are known to build better quality homes, with better design credentials, using the latest Modern Methods of Construction (MMC) to get a higher standard of construction.

Self Build homes are typically:

- — Detached homes with decent-sized gardens.
- — Two storey, four-bedrooms.
- — Average size = 218 sq m, as compared with a UK average of 104 sq m.
- — Carefully designed and constructed.
- — Higher specification of materials and build quality.
- — More energy-efficient.

## Green Building & Innovation

As the issue of climate change and sustainability remains high on the agenda, and the Government continues to incentivise energy efficiency and use of renewable sources, people becoming are more aware and educated about environmental concerns, so it's not surprising that there is a developing trend towards environmentally friendly and responsible living. Self builders have always been at the forefront when it comes to using innovative products and new technologies, and this is no different with energy-efficient and renewable systems in the home.

In a recent poll of BuildStore customers, almost a third of respondents cited "going green" as one of the main reasons for building their own home, driven primarily by concern for the environment, but also, by the long-term cost savings, and income from the Feed-in Tariff scheme. As innovation and investment in the industry continues to reduce the costs of the technology, the shorter the payback period.

"Going green" will be a growth sector for the foreseeable future, particularly with energy process rising and the FiT scheme offering a 25-year tax free income. For those who wish to have a more energy-efficient home and reduce their energy consumption overall, self building provides the ideal opportunity to reduce the carbon footprint of the construction process, and the completed home, through use of natural and recycled products and materials, as well as incorporating new technology, for example, Solar PV Panels, ground or air source heat pumps, and super-efficient windows.

## Supporting the Construction Supply Chain

The sudden collapse in national housebuilding has had a significant knock-on effect right through the supply chain affecting providers of labour, manufacturers of materials and construction professionals.

The self build industry is worth around £2 billion per year in materials, labour costs and professional fees. Self build projects help to support local labour supply and local skill bases, helping to strengthen local businesses and boost local economies.

As well an average budget of £70,000 for materials, each self build project provides the equivalent of seven full time construction jobs for on year.

Below is a typical example of labour construction labour & professionals required for each self build project:

| *Trade* | *No. of weeks of work* | *Number of workers* | *Total days per project* | *Average cost* |
|---|---|---|---|---|
| Architect | 4 | 1 | 20 | £3,700 |
| Structural Engineer | 1 day | 1 | 1 | £400 |
| Groundworker | 6 | 3 | 90 | £14,940 |
| Bricklayers | 2 | 3 | 30 | £5,520 |
| Roofer | 2 | 2 | 20 | £3,600 |
| Electrician | 3 | 1 | 15 | £2,895 |
| Plumber | 3 | 1 | 15 | £3,405 |
| Plasterer | 3 | 2 | 30 | £5,580 |
| Carpenter | 6 | 2 | 60 | £10,440 |
| Decorator | 3 | 2 | 30 | £4,170 |
| Tiler | 2 | 1 | 10 | £1,440 |
| **TOTAL** | **34 weeks** | **19** | **321 days** | **£59,790** |

## Volume Self Build

As the speculative housing market underperforms, a new volume-production model is needed to stimulate growth. Building on the self procurement ideas outlined in the 2009 publication *Self Build Moving Centre Stage*, our organisation is working on Community and Custom Build models which breaks with traditional profit-driven development and allows individuals to purchase land on larger sites specifically for self build.

These types of scheme have the potential to assist people in developing their own homes themselves or working in groups, allowing them to be more involved with the design of their property and either saving money or achieving a higher quality than they would be able to buying on the open market.

The model is very flexible and can be tailored to suit different types of people in different areas. Grouping individual builds together on larger sites removes the requirement for large scale development finance that has been so difficult to obtain in recent years, while creating significant numbers of new homes. Financial products are available to the individual builder, who can not only achieve equity in their new home but also claim back VAT on the materials used.

Land may be sourced from Local Authorities with land they can release or redistribute for housing. This means councils can benefit from the New Homes Bonus scheme, local construction industries are given a boost, and lenders can play a role in funding new housing in their local communities. The aims of the project can be defined by the Local Authority—for instance there may be a requirement for affordable housing options aimed at young families, or a luxury development to draw wealth generators into the area.

The flexibility of the Community and Custom Build models means that practical elements, such as how the plots are established and marketed, and who takes responsibility for securing Planning Permission and putting in infrastructure, can be tailored to the particular needs of the local area.

The schemes can also suit shared ownership and shared equity purchase models. For instance, a local authority may prefer to provide land at no initial charge and allow the scheme participants to buy out their plot over an extended period of time via staircasing, allowing them to purchase gradually without paying rent.

Alternatively, where there is a local housing association with development funds available, affordable housing could be hived off for a shared ownership scheme. Where there is already a substantial amount of affordable housing in an area, but still a requirement for a percentage of new development to be allocated to it, community builds are a potential solution as self builders can still complete their homes at around 10% less than market value which may be considered an affordable option.

Building as part of an organised development means that the project is more secure, providing the lender with reassurance, as well as making the process itself easier for the client. This means there is more chance for people with low incomes or low deposits to become involved in an affordable venture to build their own home.

Buildstore is working with a number of Local Authorities to support community building projects via project management or individual self build mortgage provision. For instance, a pilot Community Build scheme has just received approval from Swindon Borough Council offering 12 self build plots on the site of the former Windmill Hill Primary School, and serves as a strong example of how the self build model can be used to boost housing supply.

In Stoke, self build housing is being promoted as part of a significant regeneration scheme to bring "wealth creators" to the area. At the other end of the scale, Cherwell District Council is developing a district-wide self build programme across a number of sites and using a range of models to include affordable and intermediate housing. A number of other schemes are under consideration across the country, and the Homes and Communities Agency has released six sites as trial developments offering self build plots at Derbyshire, Bristol, Surrey, Stoke, Hemel Hempstead and Milton Keynes.

(2) *Challenges and Barriers to entry*

Land Availability

There have always been insufficient building opportunities to meet with individual demand, making it challenging for self builders to find sites—currently around 80,000 people are signed up to land-finding database PlotSearch. Our independent research has consistently shown that finding land is one of the most significant barriers to self build, 35% of respondents in a recent survey stating that it had taken them longer than two years to find a suitable building plot.

Ensuring that more land is made available for building projects, in the right locations is a key element in widening the self build market as a potential housing solution. Whilst there is a proportion of self builders who re-locate to more rural areas—usually "empty-nesters" and those close to retirement—to enable self build to become a mainstream solution, making land available in major conurbations is essential. We are increasingly seeing a response from Local Authorities who wish to include a provision for self build in their local development plans, for instance we received a request for information from Teignbridge Council recently detailing the number of subscribers to our land finding database registered in their area, and we were able to confirm suitable demand. As it appears that evidencing the requirement for self build land is difficult for Local Authorities, we are now considering issuing this information across the board in order to assist.

Self builders struggle to find land not only because there is a supply shortage; cost is another major barrier. In March 2009, 53% of clients answering a survey we conducted said that finding land at a price they could afford was one of their biggest hurdles. Land frequently usurps one third, or even half of the average self builder's budget. If land were to be offered at a reduced price as a means of assistance, this would have a substantial impact on the accessibility of self built housing. A suitable method of achieving this would be for local authorities to release publicly owned land at a reduced price, or on a shared equity basis potentially as part of a self procurement scheme, thus creating more land at a more affordable rate, significantly widening opportunities.

Finance and Lending

Self build lending was disproportionately affected by the credit crisis, has yet to fully recover. There are not enough allocated funds to meet current demand levels, despite the low loan to value and high margin that self build mortgages offers Lenders.

From around 35 lenders offering self build mortgages in 2005–06, in 2007–08, there were less than a dozen. In the last two years BuildStore has brought some new lenders into the market, but lending capacity and lending volumes are far from what they were in 2006.

Furthermore, the type of lender has changed, and the self build finance market is now dominated by small regional building societies, which have much lower lending capacities. The table below shows the current lenders in the market:

| *LENDER* | *Exclusive products through BuildStore* |
|---|---|
| **Advance stage payment mortgages** | |
| Bath Building Society | ✓ |
| Hanley Economic Building Society | ✓ |
| Saffron Building Society | ✓ |
| Melton Mowbray | ✓ |
| **Arrears stage payment mortgages:** | |
| Bath Building Society | ✓ |
| Chorley Building Society | ✓ |

| *LENDER* | *Exclusive products through BuildStore* |
|---|---|
| Ipswich Building Society | ✓ |
| Shepshed Building Society | ✓ |
| Hanley Economic Building Society | ✓ |
| Furness Building Society | ✓ |
| Darlington Building Society | ✓ |
| BM Solutions | ✓ |
| Dudley Building Society | |
| Ecology Building Society | |
| Halifax Building Society | |
| Holmesdale Building Society | |
| Leeds Building Society | |
| Lloyds TSB Scotland | |
| Loughborough Building Society | |
| Norwich & Peterborough Building Society | |
| Nottingham Building Society | |
| Progressive Building Society | |
| Scottish Building Society | |

As well as restricted capacity, lending criteria also tends to be restrictive, particularly given the temporary requirements of the self builder. The tightening of lending criteria across the mortgage market has hit self funding harder, due to the majority of self builders needing to fund two mortgages simultaneously, for at least a part of the build period. Crucially, the traditional lending multiples that usually apply are too low for self build. Most self builders will have another property, and it is unrealistic to think, in the current market, that they will sell this property before they complete their build.

On average, only one in four mortgage enquiries currently make it to application stage. This is over half what it used to be pre-credit crunch. Tightening of lending criteria has led to drop in mortgage enquiries reaching application stage, accounting for almost half all enquiries failing to proceed to application.

Because the lending is market is dominated by regional lenders, this often puts geographical constraints on lending, for example, self builders in Scotland are disproportionately affected by a lack of mortgage products.

Another concern is that some lending policies do not cover some of the MMC and eco construction methods and products, such as cladding materials, which are popular with a lot of self builders.

The amount that self builders can borrow during the course of construction has reduced. Pre-credit crunch, typical borrowing on traditional schemes was 75%–80% of land and build costs; BuildStore had exclusive advance schemes offering up to 95%, thus providing additional cash flow for self builders. Currently however, 75% lending is more typical for traditional products, with BuildStore's advance scheme offering up to 85%.

(3) *Lender attitudes to Self Build*

Lenders need to respond to the self build market, and address the need for more meaningful, practical products in order to serve the sector appropriately.

Lenders often shy away from the self build lending market, because of the perceived risk they are exposed to—the risk that borrowers fail to finish the build. However, in reality, that risk is very low, and the incidence of loss is minimal. BuildStore has seen an average repossession rate of 0.46% since 1998, and arrears rates are also low:

| *Year of completion* | *2002* | *2003* | *2004* | *2005* | *2006* | *2007* | *2008* | *Total* |
|---|---|---|---|---|---|---|---|---|
| Percentage of mortgages in arrears | 0.0% | 0.15% | 0.0% | 0.74% | 0.82% | 0.88% | 0.28% | 0.41% average |
| Comparison: CML arrears percentage | 1.04% | 0.87% | 0.89% | 1.06% | 0.98% | 1.07% | 1.88% | 1.11% average |

BuildStore has established infrastructure and risk management systems to deal with customers and monitor each project, and working with lenders, has developed specialist products that are both practical for borrowers, and offer profitable margins for lenders.

Working with an experienced finance specialist, such as BuildStore, lenders can reduce their exposure to risk, by taking advantage of other protection products, such as a specialist indemnity policy and Build Out Cover, which allow lenders to offer practical products, and reduce their loss on the rare occurrence of repossessing a partially built property.

Lenders in the self build market can benefit from:

- — Low end LTV—BuildStore customer average final LTV is 59%.
- — High margins—self build products are profitable for lenders.
- — Mature and experienced borrowers.
- — Low risk.
- — Low arrears.

Conclusion

The Government has already acknowledged the need to boost the supply of new homes and develop alternative procurements routes, in order to meet demand levels and bring stability to the housing market.

Developing a mainstream housing procurement route based on the self build model will benefit consumers, industry suppliers and lenders, and will provide a more robust, accessible and sustainable form of housing, for both private and public sector markets.

Factors which have so far inhibited the growth of the self build model, such as availability of suitable plots of land in key locations, and access to finance, are reasonably well documented and understood, and now need to be overcome in order to expand the self build market.

These barriers could be addressed by applying the self build model to volume solutions, such as Community and Custom Build schemes, which would create more opportunities for self builders in their own communities, deliver better sites and locations, and allow lenders to develop new funding products, with the added reassurance of a fully managed development.

*February 2012*

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## Written submission from the New Local Government Network

I am pleased to enclose a copy of our report *Retail Therapy*, which explores the potential of retail bonds in local government capital finance, including as a potentially attractive financing option for investment in new housing. Housing investment offers stable and fairly predictable returns over a well defined period but requires significant upfront capital; this makes fixed income debt finance well suited to housing.

While our research focused primarily on the potential for local authorities, the retail bond market is also highly relevant to private developers and housing associations. I enclose a copy of the report for information but set out here a summary of the main findings.

*What are retail bonds?*

Retail bonds are tradable fixed income debt securities issued in sufficiently small denominations to be accessed by private investors. Retail capital; that held by private individuals is seen as one of few fairly "open" capital sources in the UK. Retail bond issuance could be used by councils, housing associations and private developers to finance investment in new housing.

*What opportunity do they present for local government housing investment?*

HRA reform, affordable rent and the New Homes Bonus are all likely to encourage some local authorities to look to increase investment in new housing. However in an era of reduced central grant they are increasingly likely to have to borrow to finance this investment. The increase in the PWLB rate to 1% above Gilts has meant that in the right conditions some authorities could secure a cheaper source of credit on private debt markets. The GLA for example undershot the PWLB rate by 0.17% via a wholesale bond issuance which raised £600 million as part of the funding for Crossrail in 2011.

Previously the focus has been on wholesale bond issuance; targeted at institutional investors such as pension funds and investment banks. However retail bond issuance could provide some unique advantages alongside the potential for a cheaper cost of credit. These include:

- — *Accessibility*: many local authorities may lack the scale of borrowing requirement to access institutional investors. Retail issuance can take place on a smaller scale than wholesale issuance and as such would allow far more authorities to access bond markets to finance housing investment.
- — *Connecting citizens with capital investment*: retail bonds could be targeted locally allowing for a stronger, more local connection between citizen, council and housing investment potentially generating stronger local buy-in for new developments.
- — *Diversification*: retail bond issuance would allow authorities to significantly widen their investor base bringing stability and choice to their borrowing position.

### Barriers

There are of course some barriers to local authority engagement in this market however including current Gilt conditions which make PWLB borrowing relatively cheap in nominal terms; transactional costs associated with bond issuance; legal issues relating to use of derivatives and making coupon payments gross of tax; and a lack of certainty on the future of the PWLB rate.

### Relevance Beyond Local Government

The retail bond market could also prove an attractive financing option for housing associations. These organisations do not have the option of PWLB borrowing and many already have a presence on private debt capital markets. The retail bond market presents a significant new opportunity for these entities to tap a new source of capital, raise their profile, and diversify their borrowing portfolio.

The best example here is that of housing association Places for People who raised £140 million via a retail bond issuance in June 2011, and returned to the market with an index-linked retail bond in January 2012 raising a further £40 million. Places for People have seen significant demand for these issuances with their first issue raising more than double what they had expected. This is indicative of the appetite from retail investors for affordable housing as an asset class.

If you would like further information about our work in this area please do let me know and we shall endeavour to help.

*March 2012*

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