Housing People; Financing Housing

Natalie Elphicke

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About the Author

Natalie Elphicke is one of the UK's leading finance lawyers. She is head of Structured Housing Finance at a City-based international law firm which advises major national and international banks, building societies, housing associations, property investors, developers, public sector agencies and local authorities.

Independent commentators have ranked Natalie as a number one lawyer in her expert area of social housing finance for several years, and she has been described as "Probably the best lawyer in the City" in her specialist area. Natalie is a lawyer of choice for complex finance products involving social and affordable housing, having worked on many of the most complex and innovative finance transactions in the sector, involving several billion pounds in value.

Natalie Evans is Deputy Director at Policy Exchange, responsible for the strategic direction and output of the research team.

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Executive Summary

An opportunity to reform an important part of our economy

A new financing model for housing associations was enabled by the Housing and Regeneration Act 2008, the relevant provisions of which came into force on 1 April 2010.[1] This Act allowed the registration of "for profit" bodies as housing associations for the first time.[2]

The intention of allowing registration of "for profit" bodies as well as "not for profit" bodies is to create a level playing field for tenants by ensuring that all social landlords, whatever their constitutional structure, can come within the provisions of the Act.[3] The housing regulator, the Tenant Services Authority, has set out the operational framework under the Act to ensure that tenant standards are the same, whether the housing association is "for profit" or "not for profit".

"Housing associations are strong, successful and complex businesses, which play a significant role in our economy"

The last government tried to encourage institutional investors (like pension funds) to enter the rented sector. The analysis that institutional investors ought to be interested in the rented sector is a correct one. However, the government's scheme to encourage this – the Private Rented Sector Initiative (PRSI) – has not taken off for various reasons. A more successful approach might be to try to harness additional sources of finance from institutional investors to the existing portfolios of the successful housing associations, within a new financing structure.

Housing associations today

Housing associations are strong, successful and complex businesses, which play a significant role in our economy. They own or manage

1 Tenant Services Authority "The regulatory framework for social housing in England from April 2010" page 5

2 Clause 111 and Clause 115 of the Housing and Regeneration Act 2008

3 Hansard, House of Lords 8 March 2010

4 Tenant Services Authority: 2009 Global Account of Housing Associations, page 9 (published 25 March 2010). Table One: as at 31 March 2009, 2,380,000 homes owned or managed by housing associations.

nearly 2.4 million homes[4] – around 10% of the available housing stock in England.[5] By 2012 the number of homes that will be owned or managed by housing associations is expected to increase to nearly 3 million and to house 6 million people.[6] Furthermore, housing associations have land banks with a value in excess of £1.3 billion.[7] They own and manage major developments of hundreds of millions of pounds and are run by well paid and experienced executive teams. Housing associations own and build shops, garages, offices, market housing, intermediate/affordable housing and social housing for rent. The assets of the sector are valued at £94.6 billion, with an annual turnover of £11.6 billion.[8]

Until the late 1980s, associations were overwhelmingly reliant on government finance to build new affordable housing. Since that time the share of government grant required to finance new building has fallen to around a third. At the same time housing associations have become bigger and more sophisticated organisations that are more adept at accessing private borrowing. By building private homes for sale, and through shared ownership models, they have generated funds to cross-subsidise new investments. This has already allowed the government to get much greater value from its subsidy, and to get more homes built for the same grant.

Alternative ways to bring equity into housing associations

Until recently, equity finance has been unavailable to housing associations and any discussion around the use of equity has presumed traditional full privatisation. That is certainly an option, as privatisation – or more accurately, since the housing associations are already private organisations, "equitisation" – would harness traditional sources of equity, currently closed to social housing, to be available.

However, ownership, involvement, engagement and investment in housing ought not just be available to professional investors and professional housing management. Many tenants, local authorities

5 Information from CLG "Table 100 Dwelling stock: Number of Dwellings by Tenure and district: England; 2008/09

6 "By 2012, housing associations will own and manage around 2.8 million homes for more than 6 million people. They will provide 45,000 new rented homes every year, 25,000 for shared ownership and perhaps 10,000 new homes for market sale." David Orr, Chairman of the National Housing Federation, in the publication "moving up a gear: new challenges for housing associations", the Smith Institute (2008)

7 Tenant Services Authority: Quarterly survey of housing associations April 2010 (published 2 June 2010) page 11

8 Tenant Services Authority: 2009 Global Account of Housing Associations, pages 22 and 23

and members of the public have a strong interest in social housing, its development and its future, and in making it accountable. New housing models would make it possible to encourage and enable a wider ownership, investment and accountability. There are other successful business models which harness broader ownership, engagement and new sources of investment which could potentially be applied to the sector.

Drawing inspiration from other successful organisations, this report outlines three different structures for "social enterprise housing organisations":

1. A "BUPA" style model;
2. A "John Lewis Partnership" style model; and
3. A "Co-Op" style model.

Current housing associations could transform themselves into one of these social enterprise housing structures under the current legislative framework. Each have different strengths and advantages, and different models would be appropriate in different places so it would be up to the individual organisations to decide which would work best for them.

The advantages of equitising housing associations

At present housing associations generate a surplus of around £1.6 billion a year. Looking at the yields on similar organisations which already exist, and conservatively assuming that investors would demand a "risk premium", we estimate that this flow of funds could raise around £30 billion of equity which could replace the role of grant, and allow housing associations to build more homes with the same ratio of debt.

The government's development body, the Homes and Community Agency (HCA), states that it is currently providing

£8.4 billion of government support to deliver 155,000 new homes over four years (2008-2011), equal to £54,000 per unit.[9] Applying that grant ratio to the £30 billion of equity that could be raised suggests it would enable 555,000 homes to be developed, more than 100,000 new homes each year over five years (2011-2016). Or to put it another way, if equity did not provide the required investment funding, then the government would need £5.4 billion each year to fund the additional 100,000 homes per year suggested here.

“Equitisation may allow better value for the taxpayer, and allow affordable housebuilding to continue even if grant is reduced”

Given that government is under severe fiscal pressure, and will surely examine the future of grant funding, equitisation may allow better value for the taxpayer, and allow affordable housebuilding to continue even if grant is reduced.

Furthermore, as the housing regulator has noted, there are good reasons to think that associations could become more efficient without increasing rents or worsening conditions for tenants, who are protected by law anyway. As we explore in this report, larger associations do not seem to be enjoying efficiencies of scale – indeed their management and repair costs per unit are actually 10% *higher* than mid-sized associations. By enabling housing associations to have access to equity, the 2008 Act allows housing associations to move to a more efficient capital structure than the current all-debt model.

Improved efficiency in housing associations would allow them to make a major contribution to the economy at a time when housing in the UK is in a bad way. Housebuilding starts are currently less than 100,000 a year, when 200,000-300,000 a year are needed for the UK population. Other sources of funds for building have dried up: mortgages for home purchase are at their lowest level since 1975 and could contract further, given the dependence of the mortgage market on state funding. Nor is the government

9 http://www.homesandcommunities.co.uk/national_affordable_housing_programme

in a position to increase its spending – in fact quite the reverse. The time is right for housing associations to explore new ways of financing housing.

Business as usual?

Since the credit crunch, the government has had to provide high levels of additional finance to support the housing association sector – without this continuing support, the 1980s financing model for housing associations is broken.[10] Given the state of the public finances, reliance on this is neither realistic nor viable.

Housing associations have profits ("surpluses") which are available to support additional finance costs, be those equity or debt costs. However, there is a difference between the risk profile on equity and that of high levels of debt. Interest on debt has to be paid when due, come what may. A dividend on equity is paid only if the surpluses have been made, and payments can be deferred during a bad period. Given that housing associations house so many vulnerable people the introduction of less risky equity is preferable to increasing the proportion of debt financing to higher levels (so-called high gearing or high leverage).

It must also be doubtful whether bank lending will be available for the same duration or on the same terms as it has been in the past. The Scottish housing regulator has conducted a thorough review of the Scottish housing sector, and reported instances where housing associations are having difficulty raising debt finance since the credit crunch.[11] The Scottish housing regulator expresses concern that "… the ability of some [housing associations] to finance further increases in debt finance now looks limited."

The English housing regulator has consistently taken a more positive attitude, notwithstanding the fact that the level of new bank funded loans to the sector has dramatically declined, from around £7.4 billion in 2008/09 to around £3.5 billion in 2009/10.[12] Five

10 During the period following the credit crunch the government increased support levels to £9.5 billion. http://www.scalalandnews.co.uk/index.php?pr=news_article&newsID=149

11 http://www.scottishhousingregulator.gov.uk/stellent/groups/public/documents/webpages/shr_shapingupforimprovement.pdf

12 TSA Quarterly Survey of Housing Associations April 2010, page 6

banks and building societies lend 70% of the total loans including Lloyds Banking Group and Royal Bank of Scotland, both of which are substantially government supported. The dominance of a small group of lenders has been a long term feature of the sector. After the credit crunch, this is something of a weakness for the sector in terms of debt finance. Many housing specialists would support the Scottish analysis that finance costs for debt may increase, given that the costs of borrowing have increased for the banks themselves, and access to new bank loans may become harder.

Encouraging operational efficiency

Equity is not just less risky; it should also encourage greater operational efficiency. This is because there will be a broader range of financial stakeholders. Currently the largest housing associations fail to harness efficiencies of size, and their costs have been spiralling. The largest housing associations incur property management and repairs costs around 10% higher than mid-sized associations and do not have the highest tenant satisfaction scores.[13] Quality of tenant experience in social housing is not linked solely to the total property management and repair costs. It therefore seems likely that better scrutiny and accountability, which equity finance will bring, for the largest housing associations should bring in better operational efficiencies and therefore increased surpluses, without adversely affecting the tenant experience.

13 National Tenant Satisfaction surveys: PI data 2009, Tenant Services Authority

1. What are Housing Associations?

Housing associations: overview and historical perspective

Many people believe that social housing is provided on a small scale by a few well meaning do-gooders but they could not be more wrong. Social housing is big business. Furthermore, many people believe that housing associations are part of the public sector, perhaps even part of the local council.[14] In fact they are not – they are regulated businesses which operate in the private sector.

Housing associations are strong, successful and complex businesses. They own or manage nearly 2.4 million homes,[15] around 10% of the available housing stock in England.[16] By 2012 the number of homes that will be owned or managed by housing associations is expected to increase to nearly 3 million, housing 6 million people.[17] Housing associations have land banks with a value in excess of £1.3 billion.[18] They own and manage major developments of hundreds of millions of pounds and are run by well paid and experienced executive teams. Housing associations own and build shops, garages, offices, market housing, intermediate/affordable housing and social housing for rent. The assets of the sector are valued at £94.6 billion,[19] with an annual turnover of £11.6 billion.[20]

The stock within the housing association sector comprises general needs housing (housing subject to social tenancies), housing for older people, supported housing, shared ownership and market rent housing. A breakdown of the composition of the housing stock of housing associations can be shown as follows:

14 In this paper, the generic expression "housing associations" means not for profit bodies registered with the Tenant Services Authority (formerly, the Housing Corporation) currently called the registered providers (under the Housing and Regeneration Act 2008); who were formerly known as "registered social landlords" (under the Housing Act 1996); who were formerly known as "housing associations".

15 Page 9, Tenant Services Authority: 2009 Global Account of Housing Associations (published 25 March 2010). Table One: as at 31 March 2009, 2,380,000 homes owned or managed by housing associations.

16 Information from CLG "Table 100 Dwelling stock: Number of Dwellings by Tenure and district: England; 2008/09

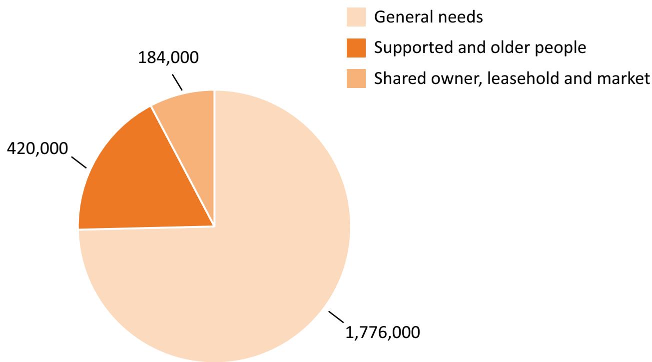
17 "By 2012, housing associations will own and manage around 2.8 million homes for more than 6 million people. They will provide 45,000 new rented homes every year, 25,000 for shared ownership and perhaps 10,000 new homes for market sale." David Orr, Chairman of the National Housing Federation, in the publication "moving up a gear: new challenges for housing associations", the Smith Institute (2008)

18 Tenant Services Authority: Quarterly survey of housing associations April 2010 (published 2 June 2010) page 11

19 Tenant Services Authority: 2009 Global Account of Housing Associations, page 22

20 Tenant Services Authority: 2009 Global Account of Housing Associations, page 23

Figure 1.1: Composition of housing association stock[21]



Social tenancies provide the highest degree of protection for tenants. In essence, provided that the tenant pays rent on time and doesn't ruin the property, they can remain in the property for as long as they choose. Social housing tenants have two levels of protection: the social housing tenancy which is governed by its own contract terms and by specific Housing Acts which afford much greater legal protection than ordinary market tenancies and a strong regulatory framework which monitors the business viability of the housing associations. The tenant protection, embedded in the Housing Acts and regulation, would remain even if the housing associations were profit distributing bodies.

The basis for the not for profit structure of housing associations is historic and political. During the late 1950s and early 1960s the reputation of the private rented sector had fallen into disgrace, becoming characterised in the public mind by low standards and profiteering behaviour, known as "Rachmanism" after the name of a particularly unsavoury and notorious Notting Hill landlord (who would have been a buy-to-let landlord in today's language). At the same time, council housing also became unpopular as, from the

21 Stock figures from Table One on page 9 of the Tenant Services Authority: 2009 Global Account of Housing Associations, presented as a pie chart. For presentation purposes, supported and older peoples housing aggregated; and leasehold, non-social rent and non-social leased figures aggregated.

mid 1950s, council housebuilding became characterised by ugly and overpowering concrete tower blocks.[22]

These outcomes had their roots directly in government decisions relating to changes in the financing of the housing sector. They were logical outcomes from funding decisions. In the case of the municipal tower blocks, higher capital grants were available for building higher blocks[23] so councils built high rise blocks; and low rent restrictions did not apply for local authorities who knocked down and rebuilt housing,[24] so councils knocked down the "slums" and built new housing with enhanced rent levels. The relaxation of rent controls in the private sector following the 1957 Rent Act was achieved by grandfathering existing tenancies and allowing higher rents on new tenancies.[25] As rents on old tenancies were protected by law, some landlords found excuses to end the existing tenancies and charge higher rents to new tenants, as the new rents could be as much as two and a half times higher.[26]

Under the Macmillian government, Sir Keith Joseph had to find a solution to a difficult political and social situation with both suppliers of rental property (council and private) so unpopular. Housing needs were severe and there were marches on the streets – a new political solution for providing rental housing was required.[27] The Housing Act 1961 allowed public finance, through interest bearing loans, to be provided to housing associations to allow them to build for letting.[28] In 1961, Sir Keith Joseph used state funding for a new "housing association", the Mulberry Trust, where a non-municipal not for profit organisation delivered rented housing using public loans.[29] The project was a success and as a result Sir Keith founded the Housing Corporation, to expand this new way of delivering housing by a responsible "social" landlord under the Housing Act 1964. The Conservative manifesto in 1964 proudly declared "We have set up a Housing Corporation which will release £300 million to housing societies, building for co-ownership and for renting without subsidy and without profit".[30] At that time, the housing associations were viewed

22 See "The Five Giants: A biography of the welfare state" Nicholas Timmins pages 189-192, and pages 184, 188

23 Timmins pages 184 and 185

24 Timmins page 183

25 Timmins pages 188 and 189

26 Timmins page 183

27 Timmins page 189

28 Housing Act 1961, section 7

29 Timmins page 192

30 Conservative Manifesto 1964

politically as what would now be called the "third sector" – not fully part of the state but pursuing government objectives with government money; not fully private but having a more socially responsible approach to the delivery of new affordable housing for rent than the pure private sector. Private finance was not a feature of the early implementation of the state supported housing associations.

Housing associations have been supported and actively promoted by successive governments as the acceptable alternative to private rented accommodation. Many established philanthropic providers of socially rented housing, such as the Peabody Trust, chose to become registered as housing associations in order to benefit from the availability of public grants for new properties. Other providers, such as Quadrant Housing Trust (now London & Quadrant Housing Trust) were established under the 1974 Housing and Planning Act which greatly expanded the availability of grants to housing associations and the role of the Housing Corporation.[31] Under the umbrella of the Housing Corporation, a disparate group of housing organisations comprising philanthophic/charitable housing organisations and housing societies/housing co-operatives were bought together and the housing sector flourished.

The next period of major financial innovation for the housing associations occurred between 1985 and 1988. The Housing Act 1985 set up the framework for what became the successful large scale voluntary transfer programme whereby councils could transfer their housing estates to housing associations so that council tenants became housing association tenants and housing associations became the owners, and landlords, of the housing estates.[32] 1987 saw three major developments in housing finance:[33] (a) a successful pilot scheme, authorised by the then Environment Secretary, Nicholas Ridley, of a loan stock financing of £65 million by North Housing Association, involving a collaboration of 14 housing associations across the South East who provided land and guarantees in exchange for nomination rights to new homes; (b) a £10 million loan from

31 Development and Change: private finance for social housing in the UK (2009) by Christine Whitehead and Peter Williams page 2

32 Development and Change: private finance for social housing in the UK (2009) by Christine Whitehead and Peter Williams page 4

33 Development and Change: private finance for social housing in the UK (2009) by Christine Whitehead and Peter Williams pages 3 and 4

Nationwide Building Society to Peabody Trust; and (c) the establishment of The Housing Finance Corporation (THFC). THFC was set up with the active involvement of the Housing Corporation in order to provide pooled access to the debt capital markets.

When private finance was first introduced into housing associations, the high levels of government grant played an important part in supporting the initial loan secured by the association as a quasi-equity, because private sector debt appetite was unknown.[34] The perceived success of the initial introduction of private finance enabled further pilot schemes which sought to reduce the amount of housing association grant required for a development from 75%-80% to 30% of development costs.[35]

Around the same time, housing associations began to explore private finance, encouraged by the Housing Act 1988. Councils meanwhile became more limited in their ability to raise finance for housing maintenance and repairs. Cross-subsidising rents from property rates/council tax was stopped by the introduction of the ring-fencing of the Housing Revenue Account (HRA) under the Local Government and Housing Act 1989.[36] Housing associations, rather than the councils, had become the primary providers of new social housing.[37] During the 1990s some councils recognised advantages in transferring their large estates to housing associations.[38] Stock transfer enabled tenants to benefit from investment and improvement in their homes by the housing associations which the councils were unable to provide.

This model of financing housing associations: bank loans; debt capital markets and government grants for new developments has remained for twenty years. However, that model is likely to change. With the public finances now under such strain, it seems highly unlikely there will be continued grant subsidy support in the form which has been in place for the last 20 years.

Furthermore it is not only the government who have financial pressures. The next chapter considers the availability of funding to the housebuilding industry – for both developments and house purchasing.

34 Development and Change: private finance for social housing in the UK (2009) by Christine Whitehead and Peter Williams page 3

35 Development and Change: private finance for social housing in the UK (2009) by Christine Whitehead and Peter Williams page 4

36 See for example the DCLG website, explanation of "What is the ring-fence and what is the effect of having the ring-fence"

37 Timmins page 432

38 Timmins page 433; Development and Change: private finance for social housing in the UK (2009) by Christine Whitehead and Peter Williams page 4

2. Money, Money, Money

Sale of housing

There are five categories of sale which are generally applicable to a major development of housing. The percentage of housing within each category will vary from development to development but they are:

1. Sales on the open market for owner occupation;
2. Restricted purchase (low cost) sales for owner occupation;
3. Shared sales (part rent; part buy) for owner occupation, but which will also have another purchaser (mainly a housing association) for the part rented purchase;
4. Sales to housing associations for long term social rent; and
5. Sales to a landlord for market rent (in recent times this has been mainly the buy-to-let market).

Reliance on loans and mortgages for sales

Categories 1, 2, 3 (all the owner occupation categories outlined above) are dominantly reliant on mortgage funding; category 5 involves mortgage funding for the buy-to-let market; in category 4 housing associations do not require mortgage funding but require loans and grants (as described above).

Housebuilders also require finance, which is known as development finance. Developments are financed by shorter term loans which allow the building to go ahead but which need to be repaid from sales within a fairly short length of time from when the house has been completed.

Each type of finance is currently under pressure. Categories 1, 2, 3 and 5 (owner occupation sales and buy-to-let) are under particular pressure due to the contraction of the mortgage market since the credit crunch. For reasons explored below, the mortgage market is set to contract still further. Category 4 (housing associations) have not been under pressure to date as they have been continued beneficiaries of significant capital grant support from the government. Housing associations are well placed to do more to support housebuilding, as detailed below, without reliance on grant, allowing them to continue to grow. If they do not access new sources of funding, and continue to rely on government grant, then given the pressures on the public finances associations could stagnate or shrink.

Housebuilders

It is well understood that there are particular pressures on the housebuilding industry. Housebuilding development finance is short term financing and is expected to be fully repaid from sales within a short time after planned completion. This means that there must be confidence at the beginning of the development, when the finance is secured, that the sales will be achieved; there must be strong management of sales risks. Over recent years, buy-to-let purchasers have provided a valuable source of sales certainty, particularly for larger developments, as they have bought properties early and off-plan. However, a recent research paper by leading valuers, Savills, has observed that there has been a reduction in such investors buying early off-plan and an increase in owner occupiers, who buy late in the process.[39] From a development finance perspective, this shift increases sales risks.

A recent research paper commissioned by the Department of Communities and Local Government (DCLG) concluded;[40]

> *"Housebuilding has been badly hit by the risk assessments made by banks and through the loss of so many financial institutions that used to provide finance. Small and medium-sized builders are particularly constrained, which means they do not have the finance to rebuild their businesses.*

39 Savills Research: "Spotlight on… New Build Housing" Summer 2010 page 3

40 The housebuilding industry: Promoting recovery in housing supply, Professor Michael Ball 1 April 2010 page 12

It is also impossible for new entrants and most occasional developers in housebuilding to raise finance for new developments. This has important implications for housing supply because around half of all new housing is provided by such enterprises. Sustained recovery in housebuilding will not take place until smaller and medium enterprises can freely operate again."

There is consumer demand for new homes in principle but money cannot be raised easily in significant sums against that demand. The number of residential sales in 2008 was at an all time low and yet only 70% of sales had accessed mortgage funding; in a usual market as many as 85% of all sales are reliant on mortgage funding.[41] The adverse situation in the mortgage market is likely to worsen.

The mortgage market

The number of new mortgages for house purchase has fallen to just over one-third of its 2002 peak, and is now at its lowest since 1975.[42]

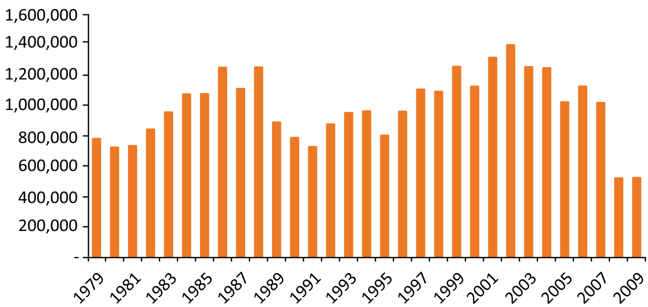


Figure 2.1: Historic series for numbers of mortgage loans for house purchase[43]

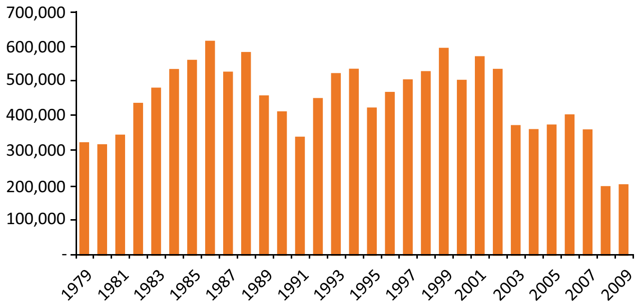
41 CML Housing Finance Issue 02 2009 "The changing nature of property sales" pages 1 and 8

42 Total numbers of mortgages (UK): Table ML4 (Council of Mortgage Lenders, date mark 10/6/2010) 1975 (671,100); 2009 (518,800) peak 2002 (1,396,700), 2009 is 37% off peak level.

43 Total numbers of mortgages (UK): Table ML4 (Council of Mortgage Lenders, date mark 10/6/2010)

Meanwhile the number of new mortgages for first time home purchase has fallen to one-third of its peaks in 1986 and 1999, and is now at its lowest since 1975.[44]

Figure 2.2: Historic series for numbers of mortgage loans for first time buyers[45]



Sources of mortgage funding: Funding of UK mortgage debt is highly dependent on government/Bank of England supported funding through the Special Liquidity Scheme (SLS) and the Credit Guarantee Scheme (CGS). These however are due to be removed in stages between 2011 and 2014,[46] which will require around £300 billion to be refinanced through other sources in the money markets, and, most likely, without further government support. The Council of Mortgage Lenders have noted that the capacity of the mortgage market to continue at its current levels, let alone grow, is a challenge: "The scale of funds provided through the SLS and CGS is such that it is difficult to see how unsupported markets can refinance them."[47]

In the years to 2014, it is evident that the mortgage market is unlikely to be able to support any significant increase in availability of mortgages. The most likely scenario is therefore a potentially

44 Information from the historical time series from CML (ML2: First-time buyers: lending and affordability). The number of loans in 1975 was 259,000 and the number in 2009 was 199,000. The peaks are 1986 (612,700) and 1999 (592,400); 32.5% and 33.5% from peaks.

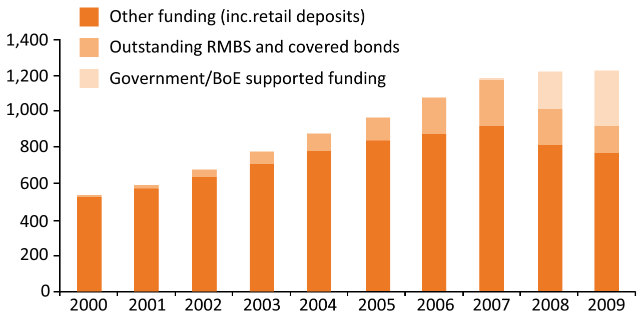
45 Total numbers of mortgages (UK): Table ML2 (Council of Mortgage Lenders, date mark 5/7/2010)

46 CML Research paper: the outlook for mortgage funding markets in the UK 2010-2015, page 4

47 CML Research paper: the outlook for mortgage funding markets in the UK 2010-2015, par 99, page 18

severe contraction, bringing more pressures on housebuilders and homeowners. Currently around 25% of mortgage funding is supported which equates to around 2.84 million mortgages.[48]

Figure 2.3: CML Analysis: The Funding of UK Mortgage Debt [49]



The Private Rented (buy-to-let) market and property investors: Recently, the buy-to-let market has suffered from a lack of available mortgage funding, having initially rallied at the onset of the credit crunch. The percentage of loan advances for buy-to-let purposes halved between the second quarter of 2008 and the first quarter of 2009 as the sector continues to be adversely affected by general mortgage availability.[50] It is therefore unlikely that the buy-to-let sector will be able to contribute to an improvement in the fortunes of the housebuilders to any significant extent in the short term. Specialist property holding companies might be able to raise equity finance to support housebuilding and while there is certainly evidence of cash based transactions – many of which are likely to be for investment – the data on this is limited.[51] On the scale supposed at present, the property holding companies have a contribution which is likely to be helpful, but modest, given the scale of the challenge.

48 If Government support at 25% of mortgage markets and the number of mortgages is 11,374,000 then the number indirectly supported would be 11,374,000 (x.25%) = 2,8435,000. Number of mortgages taken from CML Table AP1, first half 2010 figure

49 CML Research paper: the outlook for mortgage funding markets in the UK 2010-2015 page 7, Chart 2

50 CML Research Table 22/6/2010: Table MM22 Gross advances by purposes of loan, FSA data. 12% of total gross advances in Quarter 1 of 2008; down to 6% of total gross advances in Quarter 1 of 2009 (where it has fluctuated between 5 and 6% to Quarter 1 2010).

51 For an interesting discussion on cash purchases, see CML Housing Finance Issue 02 2009 "The changing nature of property sales" pages 8 and 9

Local Authorities: It has been suggested that Local Authorities could have a larger role to play in housing delivery. However, the scope for significant developments being financed and delivered by them will be restricted by the national requirement to significantly and quickly reduce public sector borrowing. The government is committed to reducing the total public net borrowing from £154.7 billion to £20 billion by 2016;[52] and to reducing revenue spending by 25%. Borrowing undertaken by local authorities is included within the calculation of the public net borrowing.

Smaller scale housebuilding programmes may be delivered by the reform of the Housing Revenue Account (HRA). Tax incremental financing or similar applications of new Council Tax revenues for instance, could help bring forward limited programmes on council owned sites (such as converting garages to additional housing) and to funding repairs. However, it seems unlikely that Local Authorities will be able to secure significant funds to assist with large scale developments, although they may be able to stimulate activity by deferring consideration for land which they own, or by taking part on joint ventures with other parties.

“It seems unlikely that Local Authorities will be able to secure significant funds to assist with large scale developments”

Private Rented (Institutional Investment) Funds: From a financing perspective, one solution to the lack of mortgage funding to fund housebuilding sales is to attract new sources of finance. This is the rationale of the Private Rented Sector Initiative (PRSI). PRSI is described by the HCA in the following terms:

> *“The HCA’s Private Rental Sector Initiative (PRSI) is designed to attract institutional investors, such as UK pension and overseas funds that have not traditionally been involved in residential letting, into the market at scale for the first time. Used to fund the building of new homes specifically for private rent, it could help relieve pressure on the housing market*

52 Table B1 Emergency Budget June 2010 page 72

53 Homes and Communities Agency website. Press Release 10 June 2009

by kickstarting stalled developments, as well as making private rental an option of choice for consumers in the future."[53]

The PRSI has been developed using public sector funds, and is intended to benefit from a public sector grant from the "kickstart" programme.[54] The investors would not, of course, manage the properties and management would be undertaken by housing associations or private sector managers, such as Grainger PLC.[55]

The analysis that institutional investors ought to be interested in the rented sector is correct. However, that the PRSI has not achieved the early successes should not be a surprise. After 64 expressions of interest, some key major investors have left the scheme before launch.[56] In addition, it has been reported that the success of a PRSI fund for private rented housing appears to require government support through the provision of subsidised land and/or completed property in order to off-set development risks. There has been reported concern about the duration of market rent tenancies, which can be only 6 months and consequential voids, arrears and higher management costs from an increased turnover of tenants.[57]

By contrast, housing associations already have substantial property, good void and collection records and stable rented income so they should not need additional government support. The next chapter explores how an additional source of finance – institutional investors – could be much better harnessed to the existing portfolios of the successful housing associations within a new financing structure.

54 Homes and Communities Agency website. Press Release 10 June 2009

55 Homes and Communities Agency website. Press Release 10 June 2009

56 http://www.building.co.uk/news/legal-and-general-backs-away-from-private-rental-initiative/3159681.article

57 http://www.insidehousing.co.uk/analysis/in-depth/where-is-housing%E2%80%99s-white-knight?/6510421.article

3. A New Financing Structure for Housing Associations

What would a new financing model look like?

Table 3.1: TSA Framework for application of standards under the new regime[58]

Standard	Does the standard have cross-cutting elements across all standards?	Apply to local Auth-orities?	Apply to non-profit registered providers (RPs)?	Apply to for-profit RPs?	Apply to low-cost rental?	Apply to low-cost home ownership or intermediate rent?
Involvement and empower-ment	Yes	Yes	Yes	Yes	Yes	Yes
Home	No	Yes	Yes	Yes	Yes	Yes
Tenancy	No	Yes (apart from rents)	Yes	Yes	Yes	No
Neighbour-hood and community	No	Yes	Yes	Yes	Yes	Yes
Value for money	Yes	Yes	Yes	Yes	Yes	Yes
Governance and financial viability	Yes	No	Yes	Yes	Yes	Yes

For the first time since the implementation of the Housing and Regeneration Act 2008 there is the legal framework in place to make equity in housing associations a reality, with the relevant provisions coming into force on 1 April 2010.[59] The intention of allowing registration of

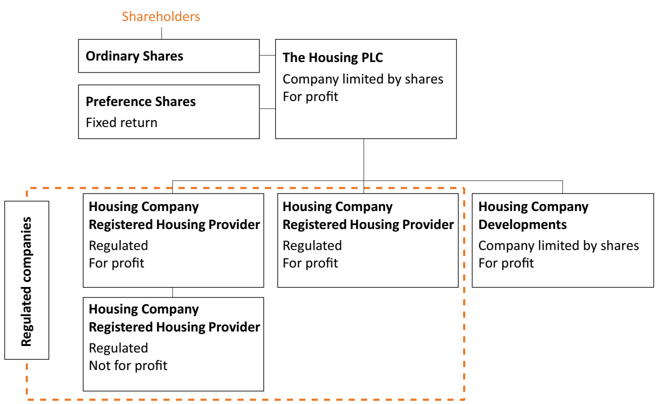
58 Tenant Services Authority "The regulatory framework for social housing in England from April 2010" page 35

59 Tenant Services Authority "The regulatory framework for social housing in England from April 2010" page 5

"for profit" bodies as well as "not for profit" bodies is to create a level playing field for tenants by ensuring that all social landlords, whatever their constitutional structure, can come within the provisions of the Act.[60] The housing regulator, the Tenant Services Authority, has set out the operational framework under the Act to ensure that tenant standards are the same, regardless of financing structure.

Previous discussion around equity for housing associations has presumed traditional full privatisation, and that is certainly an option. A privatisation, or more accurately since housing associations are already private organisations, an "equitisation" would harness traditional sources of equity, currently closed to social housing, to be available (shares and fixed rate preference shares) and quasi-equity products such as subordinated loan notes. In addition a more balanced debt market would be available to equitised housing associations, including fixed income securities. A full equitisation would be likely to create a structure similar to that of the regulated utilities. It would harness new funding through shareholder equity investors, and would be likely to issue preference shares. It might look like the structure outlined below.

Structure Chart 3.1: Full Equitisation Model



60 Hansard, House of Lords 8 March 2010

Social Enterprise Housing Models

Examples of new Social Enterprise Housing Models

Ownership, involvement, engagement and investment in housing ought not just be available to professional investors and professional housing management. Many tenants, local authorities and members of the public have a strong interest in social housing, its development and its future, and in making it accountable. New housing models would make it possible to encourage and enable a wider ownership, investment and accountability.

Drawing inspiration from other successful organisations, this report outlines three potential structures for social enterprise housing organisations:

1. a "BUPA" style model (the BU-SEP);
2. the "John Lewis Partnership" style model (the JEP-SEP); and
3. the "Co-Op" model (the CO-SEP).

The current housing associations could transform themselves into one of these social enterprise housing structures under the current legislative framework. In addition other variations could be available, underpinning the individuality in culture, history and aims of the association. This could be achieved through the flexibility provided by a full range of organisational structures. The structures chosen as examples reflect three different types of social enterprise, all of which are highly successful commercial organisations: mutual ownership (Co-Op), employee stakeholder (John Lewis) and a corporate organisation where profits are re-invested in the business (BUPA). The model which is closest to that currently operating in housing is the BU-SEP.

A BU-SEP (BUPA-style social enterprise model)

Why a BU-SEP?

The group holding company of BUPA is a company limited by guarantee without shareholders. Many large housing associations operate similarly under a "locked" corporate structure. As BUPA does not have traditional shareholders, it has needed to find a source of equity-equivalence which is acceptable to its financial regulator, the Financial Services Authority (FSA), in relation to its insurance business (BUPA is required to maintain a sensible debt position which is not overleveraged to equity).

The financing of BUPA is not dependent on government support. Instead the company have a "perpetual bond" which is technically a debt instrument but treated as equity.[61] The unsecured perpetual bond is interest bearing at 6.125%.[62] The terms of the bond allow BUPA to defer the payment of interest in specific circumstances, so it is not like debt interest on a loan, where non-payment will cause default.[63] The use of the perpetual bond is similar to the treatment of the government capital grant as equity for housing associations as described above.

What would a BU-SEP model look like?

Under a BU-SEP structure the housing association group would comprise a top company, which would be preserved as a "not for profit" company. Like BUPA, a new finance PLC would become the intermediary holding company and raise the debt and quasi-equity. The top company (the "not for profit" parent company) and its intermediary holding company (the finance PLC) would not be regulated housing associations. Neither of these holding companies would have a direct relationship with tenants. It is likely that the operational companies (the tenant companies) would split so that there was a company to specialise in the provision of social housing for rent; and a company to specialise in other affordable housing

61 See an explanation of the share capital and capital treatment at page 84 of BUPA Finance PLC financial statements: http://www.bupa.com/jahia/webdav/site/bupacom/shared/Documents/PDFs/financial-information/directors-report-financial-statements-2009.pdf

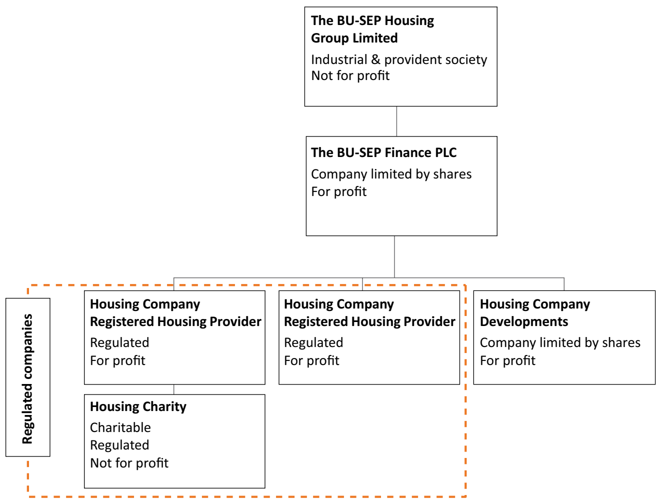
62 This is the rate of interest to 2020, then the interest level is re-set and BUPA have a right to call (pay back and refinance) the perpetual bond. http://www.bupa.com/financialinformation/bupa-borrowings

63 See clause 4 of the instrument at: http://www.bupa.com/jahia/webdav/site/bupacom/shared/Documents/PDFs/financial-information/Prospectus-hybrid%20330m.pdf

and general housing activities. The operational company which provides social housing for rent would be regulated with the housing regulator and it would have the direct legal and regulatory relationships with tenants and the housing regulator as happens now.

The BU-SEP housing group might have a similar structure to that outlined below:

Structure Chart 3.2: BU-SEP Model



What would be the effect of a BU-SEP?

The BU-SEP model would allow housing associations broader access to more and complex types of debt, and quasi-equity. It would have no adverse effect on the existing social tenants, for the reasons described above and would enable associations to continue to grow without government grant.

A JEP-SEP (John Lewis equity Partnership-style social enterprise) model

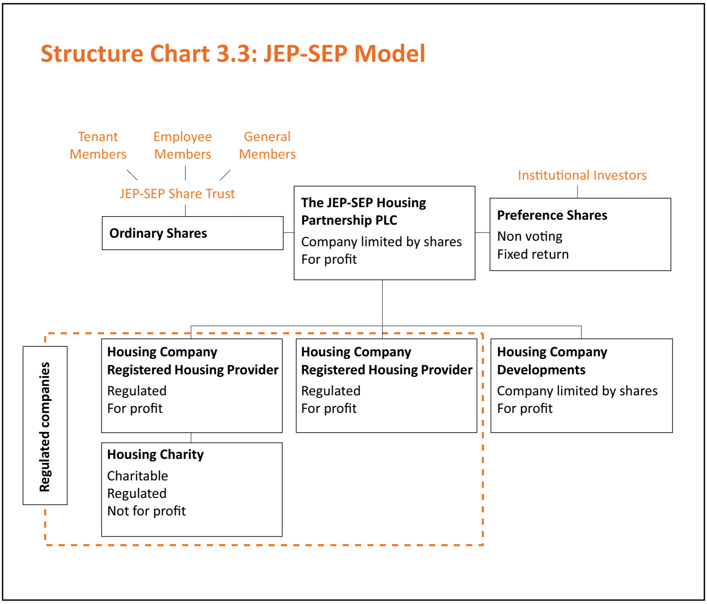
Why a JEP-SEP?

New models for housing finance could include one based on the structure of John Lewis. This would mean that, instead of a "not for profit" model, ordinary shares and dividends would be payable to a shareholding Trust. The shareholding Trust for a housing company could be held for the benefit of its tenants, its employees, and ordinary members of the Trust. The Trust constitution would set out voting rights so, for example, one group could not gain control at the expense of others.

Recognising the potentially broader role that housing companies could have where, for example, public sector land is provided for development through its finance raising capability, the beneficiary members could include local authorities or health trusts or schools. This might be one way to bring forward land development without the public authority (and the expense, delay, voting and procurement challenges that they have) while ensuring that some long term equity return is captured.

What would a JEP-SEP look like?

Under a JEP-SEP the ordinary shares would be issued to the JEP-SEP Share Trust; these shares would attract voting rights and dividends. The Share Trust would be controlled by a partnership deed which would set out the membership, representation rights and sharing of proceeds arrangements. Additionally, John Lewis for instance, has successfully utilised a preference share structure with 5% and 8% shares to harness more equity, without distributing the partnership trust shares.



What would be the effect of a JEP-SEP model?

The JEP-SEP model allows a broader access to more and complex types of debt, quasi-equity, and equity. It would have no adverse effect on the existing social tenants, for the reasons described above and would enable housing associations to continue to grow without government grant.

The CO-SEP (Co-Op style social enterprise) model

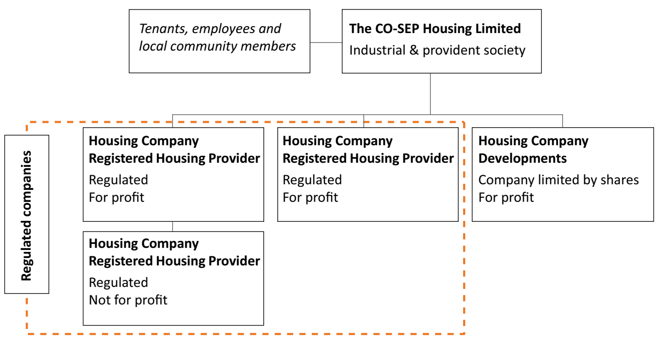
Why a CO-SEP?

The CO-SEP model permits a true mutual housing association. Like the JEP-SEP model, profits can be shared out at the top level, allowing the capital to be used from "members" (equity investors) to enable the company to operate fully and commercially. This might be an attractive model to local authorities who still hold their own stock and allow initial shareholders to be tenants and Council Tax payers in the relevant authority area. It would also be possible to set up a new housing co-operative to bring in new finance and investment, while retaining local ownership.

What would a CO-SEP model look like?

Under a CO-SEP there would be a large membership which would have voting rights and shares in profits. CO-SEP could also issue bonds like the BU-SEP model.

Structure Chart 3.4: CO-SEP Model



What would be the effect of a CO-SEP model?

The CO-SEP model allows a broader access to more and complex types of debt, quasi-equity, and equity (through members' funds). It would have no adverse effect on the existing social tenants, for the reasons described above and enable housing associations to continue to grow without government grant.

Which social enterprise model?

Different housing associations will have different historic, legal, cultural or ideological reasons for preferring a particular model. For some, full equitisation on a traditional privatisation model would be unacceptable. The new opportunities for "for profit" and "not for profit" models do not just create the opportunity to equitise by privatisation; they also provide the opportunity to create new Social Enterprise Housing Models for the benefit of the housing association movement. Whichever particular social enterprise option is chosen the rationale is the same, to unlock additional investment in order to provide new homes and stimulate economic growth, without requiring government grant.

"Whichever particular social enterprise option is chosen the rationale is the same, to unlock additional investment"

4. Identifying and Unlocking the Equity Value

How financially strong are housing associations?

The financing cashflows of the housing association sector as a whole are extremely strong. As noted earlier, the assets of the sector are valued at £94.6 billion,[66] with an annual turnover of £11.6 billion.[67]

Figure 4.1: Housing association sector turnover[64]

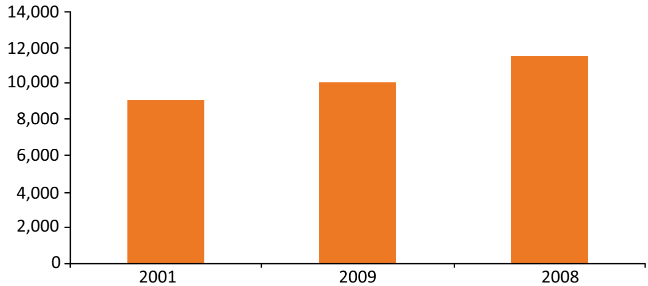
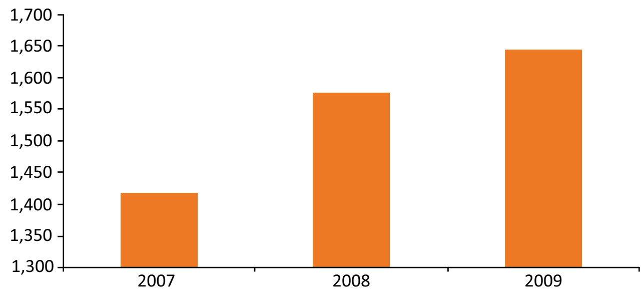


Figure 4.2: Housing association sector operating surplus[65]



64 Tenant Services Authority: 2009 Global Account of Housing Associations, page 23

65 Tenant Services Authority: 2009 Global Account of Housing Associations, page 23

66 Gross book value, Tenant Services Authority: 2009 Global Account of Housing Associations, page 21

67 Tenant Services Authority: 2009 Global Account of Housing Associations, page 23

The turnover (revenues) and operating surplus (profit) for the sector have continued to grow strongly during the three years of the credit crunch.

Financing a housing association

Over time housing associations have proven their viability, good management and ability to withstand different economic cycles. They have an enviable track record: there are no bad loans which have resulted in a loss for any private lenders and they can attract top level financial ratings with the rating agencies.[68] However, they have been over-reliant on public grant and are becoming increasingly leveraged with debt.

As noted in Chapter 1, the model of financing housing associations – debt and government grants – has been in place for twenty years and has resulted in an overall position of broadly 50:50 split between grant and debt. This division has been the position for a number of years, as the lenders have viewed grant as a type of equity. In order to raise private finance, there has been a necessity for the government to continue to provide grants, resulting in £37 billion being invested in the sector to date.[69]

How much equity could be raised and how many houses could be built and acquired?

If a different financing model were adopted, there is equity value in the housing association sector of around £128 billion. Using current income, this could raise around £30 billion of new equity for investment into social housing, as explained below.

Balance sheet equity

The Global Accounts[70] highlight that housing associations own a total of 2,380,000 social housing properties.[71] They also set out

68 See, for example, Home Group housing association achieves 'A+ ' Standard & Poors rating, 16 June 2010

69 "The sector's two main sources of capital finance remain debt and SHG. During 2009 the total external debt of the sector increased by £5.1 billion to just over £40 billion. Total capital grants, SHG and other capital grants, have risen by £3 billion to £37 billion." TSA Global Accounts 2009

70 Global accounts for social housing are maintained by the Tenant Services Authority (TSA). On 25 March 2010, the TSA published the 2009 global accounts of housing associations ("Global Accounts"). http://www.tenantservicesauthority.org/server/show/ConWebDoc.20212.

71 at page 9, Global Accounts

the global balance sheet of housing associations.[72] The accounts are not in an entirely traditional style, but it is possible to extract key numbers:

- The gross book value of all sector assets is stated to be £94.6 billion;[73]
- The total debt is stated to be just over £40 billion;[74] and
- The total social housing grant is stated to be £37 billion. Grant is a debt in principle repayable to the government.

Expressing these figures in a table, it is possible to determine the current equity in all housing associations:

	£ billion
Total assets	96
Debt	40
Total equity before grant	56
Less grant	(37)
Total equity After grant	19

However, these figures do not tell the whole story. The gross book value basis of housing association assets is mainly historic, not current. Taking a considered valuation analysis by the government in 1999 and updating it, the average social housing unit is worth around £118,000.[75] Taking an extremely conservative view (and one which is accepted by bondholders) that the properties are worth 50-70% of general market value, that would mean that social housing properties have a value of around £86,000.[76] 2.38 million social housing units with an average true value of £86,000 values the sector at around £205 billion, so restating the balance sheet on a current valuation basis reveals the following:

72 page 20 onwards. Global Accounts

73 at page 21, Global Accounts

74 at page 22, Global Accounts

75 CLG table 544 average house prices in the UK. 2009 = £172,415; a detailed exercise which included valuing the housing association and LA sector was produced by DETR in 2001, and that detailed report on valuations put average property values for the housing association sector at £49,750 when national prices (all properties) were at £72,427 (housing association sector property at 69% of national pricing). (See DETR paper at http://www.corby.gov.uk/Housing/CouncilHousing/Documents/Guide%20to%20Social%20Rent%20Reforms.pdf) Taking that percentage and applying it would give £118,000 for 2009 all properties figures from the CLG table.

76 Page 31 of THFC market analysis. See http://www.thfcorp.com/investing/THFC%20-%20Investing%20in%20Social%20Housing%20230510.pdf

	£ billion
Total assets	205
Debt	40
Total equity before grant	165
Less grant	(37)
Total equity after grant	128

It is therefore possible to see that the net asset value – or balance sheet equity – of social housing stock is in the region of £128 billion.

Equity raising potential

It is not enough for there to be a substantial asset backing. It is also important that there are revenues capable of supporting dividends. The Global Accounts also set out the income and expenditure accounts of all social housing lettings.[77] Taking the relevant figure, these reveal:

Year	2007	2008	2009
Turnover (£ million)	7,839	8,547	9,484
Increase (%):	–	9%	11%
Total expenditure (£ million)	6,442	7,002	7,840
Increase (%):	–	9%	12%
Surplus (£ million)	1,397	1,545	1,644
Increase (%):		11%	6%

The surplus rose more slowly between 2008 and 2009 as management costs increased, underlining the importance of efficiency, which pressure from external investors would help to address.

77 at Table 7 on page 25, Global Accounts

Taking the surplus in the sector to be £1,644 million, there is clearly capacity to raise debt. However the emphasis should be on de-leveraging the sector to better protect tenants who are some of the most vulnerable people in Britain. Equity is more attractive as a failure to pay dividends does not cause the entire business to collapse.

How much equity could be raised?

The amount of equity that could be raised depends on the level of dividends investors would seek and the model used. If the model were to be a full equitisation with the issue of ordinary shares – e.g. a market float – the dividends could be lower as shareholders would participate in future value increases in the business. Typical current comparisons would be Grainger PLC which has a dividend yield of 2.4%, Land Securities at 3.5% and Hammerson at 4.1%.[78] A dividend for such a strong asset backed by a dependable revenue stream that is growing at a rate of around 10% per annum would be an attractive stable stock. As such, it could be expected to be at the lower end of the range, say in the region of 3%. Taking £1,644 million as the dividend "pot", the equity raised on this basis could be in the region of £55 billion.

"A dividend for such a strong asset backed by a dependable revenue stream that is growing at a rate of around 10% per annum would be an attractive stable stock"

If the model were on a fixed rate preference share style of equity participation, investors would not receive the benefit from future increases in the value of the property portfolio. The yield would therefore need to be greater, indeed, it would need to be greater than the yield on government debt. Currently long term gilt yields are in the region of 4%. A "risk premium" would therefore be required and the necessary yield would therefore need to be 5%-6%. Taking the £1,644 million dividend "pot" the equity raise on this basis would be around £30 billion.

78 Daily Telegraph business pages, B6, 10 September 2010

Is the yield realistic?

There are already examples of successful private equity investment in the affordable and market rented sector. One example is affordable housing company Assettrust Limited, for which the yields targeted are not racy: 3%-4%.[79] The company is debt funded, raises equity and is successful, without a penny of grant. The Assettrust model recognises that a properly financed housing vehicle, with sensible investors looking for longer term returns and a reasonable amount of debt, can be a viable proposition.

This experience is confirmed by the £300 million tenanted residential (market rent) fund which has been set up by Aegon Asset Management and listed developer Terrace Hill. This fund is said to target a 5% distribution yield.[80]

Assessing the appropriate yield for a new market, as equity capital investment into the housing associations would be, is notoriously difficult. However, taking a broad range of different share and preference stock information, from property development companies, market rented companies, and social enterprise businesses it does seem that yields of between 3% and 7% are realistic, and that given the stable and strong businesses of housing associations, a lower end yield ought to be targeted.

Are housing associations attractive to investors?

The regulator for housing associations, the Tenants Services Authority (TSA), recently published a paper looking at the performance of housing associations during the credit crunch. The paper concluded: "Overall, the [housing association] sector's trading performance has come through the economic turbulence relatively unscathed."[81]

The paper also supported a role for investors in the future stating

> *"The [housing association] sector is unlikely to generate market-leading returns on investment, due to its low margins, restricted income streams*

79 The Telegraph, "Boost to affordable housing", 10 June 2007

80 http://www.propertyweek.com/aegon%E2%80%99s-%C2%A3300m-residential-fund/3160637.article

81 Tenant Services Authority "Impact of the Credit Crunch on Housing Associations" page 5, (published 24 February 2010)

and high capital intensity. However, the same factors that constrain it also give it stability and potential. Provided housing demand remains high, lending rates remain favourable and rents predictable, this analysis demonstrates that the [housing association] sector's core business offers potential for secure investment and growth when there is turbulence in the wider economy."[82]

The analysis undertaken by the housing regulator debunks the myth that rents will need to increase in order to generate profits to share with equity holders. Indeed the financial analysis provided in this paper is predicated on all of the existing conditions for housing associations, including a conservative approach to long term growth from rental income on individual properties, and restrictions on sales of social housing property. The new financial structures outlined in this report would result in continued growth: where new capital used to purchase new homes which have an additional rental income stream to raise capital to purchase new homes which have an additional rental income, and so on.

Investor Type

That there is a distinction between investors who are interested in different assets and time frames is commonly recognised. An example of the distinction between leveraged investors (such as hedge funds) and unleveraged investors (such as pension funds) is explained as follows; "Typically, demand from leveraged investors is quite cyclical, rising and falling with the credit cycle, while demand from unleveraged investors such as pension funds tends to be more stable over time, reflecting the more stable profile of pension saving".[83] Accordingly, housing association businesses should be attractive to long term settled pension fund investors who will be looking for stable, long term returns.

82 Tenant Services Authority "Impact of the Credit Crunch on Housing Associations" page 5 , (published 24 February 2010)

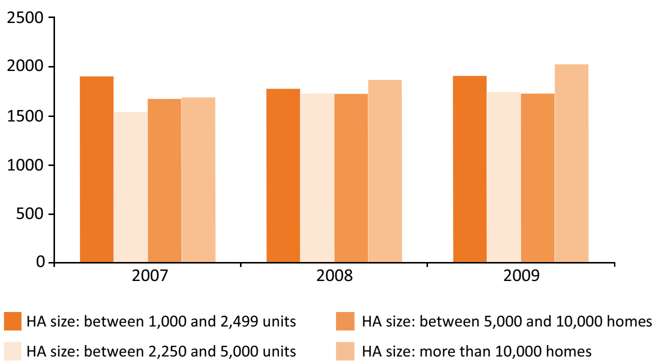
83 CML Research paper: the outlook for mortgage funding markets in the UK 2010-2015 page 9

Efficiency savings

The housing regulator has separately observed that there is scope to improve the efficiency of housing associations in their management and maintenance of properties. The sector enjoys its reputation for "gold plating" – always aiming higher and better than the minimum required, yet it is not always the case that such an approach delivers best value for tenants. As the housing regulator expressed in relation to these constrained times "improvement in operating efficiencies are likely to become increasingly important".[84]

There does seem to be a specific problem with the cost of housing maintenance and repairs in the social housing sector: the largest housing associations do not generally seem to be able to benefit from the usual economies of scale but rather incur extra costs due to management and maintenance which equate to approximately £4 a week in rent or £200 per year. Assuming benefits of scale, that difference ought to be greater still.

Figure 4.1: Management and repair costs of housing associations by size[85]



84 Housing Association Global Accounts 2009 Page 6

85 Housing Association Global Accounts 2009 Table 12

Higher rents are not just an extra housing benefit cost passed on to the state – it is also a charge on some of the lowest paid workers as more than 35% of the sector's tenants do not qualify for housing benefit.[86] A social enterprise housing model might encourage better accountability and more efficiency, not just in order to increase equity returns, but also to keep social rents as affordable as possible for social housing tenants.

Clarity on grant debt

It will be important for new equity providers to understand the legal basis of grant debt. They will need to understand how much grant is repayable, on what terms and when it is due to be repaid, compared to their own equity claims. The treatment of grant debt as quasi-equity creates a confusion. If there were a financial collapse of a housing association, grant debt is a repayable debt which would rank behind secured creditors (i.e. the current debt lenders) and equal with other unsecured creditors, in other words ahead of equity. It would not be ranked alongside equity claims. This means that, while grant debt is treated as equity to the loan providers (thus increasing available debt), it is treated as debt to the equity providers (thus reducing available equity).

When housing associations start to access these new models of finance, it seems likely that investors will want greater clarity about the terms on which grant debt is repayable. This might be provided by repaying the grant debt, converting grant debt to a subordinated loan with an agreed interest and repayment schedule, converting grant debt into equity shares or loan stock or writing off all or part of the historic grant debt.[87] Interestingly when "advances for developments" were made available to housing associations under the 1961 Housing Act, they were interest bearing (on the same basis as loans to local authorities) and were repayable over a period not exceeding 60 years.[88] On this measure, housing associations have

86 As at 2007, Table 718 (CLG livetables) there were 63% of social tenants in receipts of housing benefit

87 For an analysis of repayment of grant through issuance of shares see Adrian Bell, then Chairman of Royal Bank of Canada Europe in "social housing: breaking new ground", the Smith Institute (2007) pages 75 and 76

88 Housing Act 1961, section 7(2)

enjoyed an extraordinary and extended period of receiving grant without an interest rate or a repayment schedule.

Currently the terms of grant repayment are not merely contractual; they are set by regulatory decree. Equity providers would want to ensure that grant terms are clear and certain. Government could provide this clarity in one of three ways:

1. By writing off grant debt entirely. However, given the current state of public finances it is unlikely to be acceptable merely to write off £40 billion grant debt to housing associations where they have at least £128 billion of surplus value;
2. By agreeing contractual terms for long term repayment of grant debt (perhaps like the original concept of housing association debt, namely over 60 years); or
3. By converting the current debt into equity stock, probably preference loan stock, which would attract a stated equity return when the housing association is in profit, but which would not attract any voting rights or other operational controls.

5. How Would These Models Help Stimulate Housebuilding?

Why are more homes needed each year?

"A weak supply of housing contributes to macroeconomic instability and hinders labour, market flexibility, constraining economic growth."[89] This was the conclusion of the most important review on housing supply in recent times, the Barker Report, published in 2004. In addition to its contribution to macroeconomic instability, weak housing supply results in a rise of real housing price growth and unaffordability.[90] When the Barker Review was commissioned, the main housing supply constraints were planning, supply of land and skills in the construction industry. In today's climate the main problem is money.

"The current number of homes being started represents around a third of the number of homes recommended by the NHPAU to meet housing need"

Barker concluded that between 227,000 and 281,000 new homes were required each year. At that time the government was working to a baseline figure of between 140,000 and 160,000.[91] The National Housing and Planning Advisory Unit (NHPAU), which was established following the Barker Review to provide an ongoing independent view on affordability and housing, estimates that between 238,000 and 290,000 new homes are required each year.[92]

The number of new homes started in England last year (2009-10) was almost half of the number being built when the Barker Review reported – 87,360 – only a slight increase on the 80,360 new homes which were commenced during 2008-09.[93] In other words, the current number of homes being started represents around a third of the number of homes recommended by the NHPAU to meet housing need.

89 Barker Report: "Review of Housing Supply. Delivering Stability; security our future housing needs" March 2004, Foreword page 1

90 Barker Review page 3

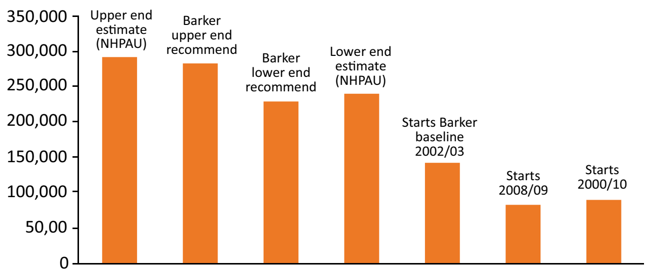
91 Barker Review pages 20 and 21

92 Council of Mortgage Lenders ("CML"), News Issue No 4, 2 March 2010

93 Communities and Local Government (CLG) Table 208 "House building: permanent dwellings started, by tenure and country"

If the number of new homes being built does not increase substantially over the short to medium term there could be a lasting negative impact to the country in a macroeconomic context.

Figure 5.1: Number of new homes required to meet housing need (each year)



Is there a need for more social housing?

In an individual context, housing need is extremely high yet the social housing sector has reduced in size. Waiting lists have been increasing in recent years, even before the impact of the credit crunch. There are high levels of overcrowding with housing need being for larger family homes. In recent years, however, the wrong houses have been built by social landlords.

Size of the Waiting List: There are around 1.75 million households on the waiting lists for housing which are held by the local authorities – a rise of 75% in the last decade.[94] The increase in waiting lists is a trend dating from 2001, pre-the credit crunch.

94 Table 600 CLG 1million to 1.7 million

95 CLG Table 813 (number of children in poor housing)

96 "Good housing has a key role to play in influencing the overall living standards of a family. Children's development and well-being is dependent on tackling all relevant dimensions of poor housing. If a home is overcrowded it can affect health and educational attainment and can impact negatively on life chances. Living in overcrowded accommodation can, both directly and indirectly, have a devastating effect on families. Under-achievement at school can be caused by lack of space for children to do their homework. Older children may spend more time outside the home, on the streets, simply to find privacy and space. Poor housing conditions can cause a range of physical and mental illnesses and children growing up in difficult housing conditions are 25% more likely to suffer severe ill-health and disability during childhood/ early adulthood. Overcrowding is a key component of poor housing." Tenant Services Authority report "Overcrowding and under-occupation" October 2009

97 CLG Table 807 Overcrowding in England by region and tenure 2005/06-2007/08. Rate of Overcrowding for England overall is 2.7 but the overcrowded rate is 5.9 for social rented sector as against 1.4 for owner occupied housing.

98 CLG Table 807 rate of overcrowding by tenure: 12.7 for the social housing sector in London as against the average overcrowded rate for England of 2.7.

Figure 5.2: Historical series for number of households on the local authority waiting list for housing)

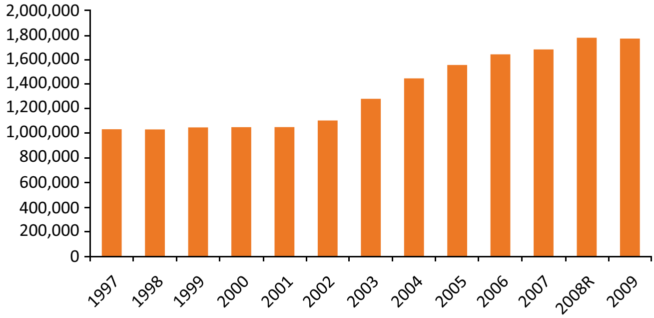
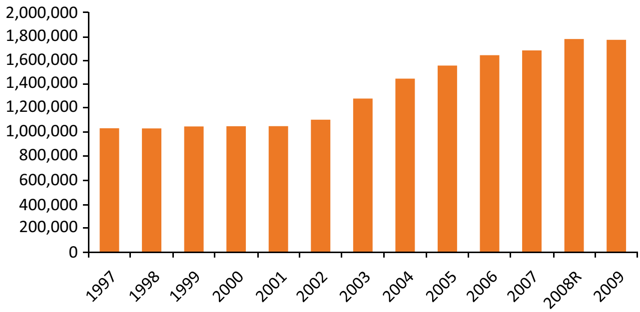


Figure 5.3: Number of children in overcrowded homes[95]

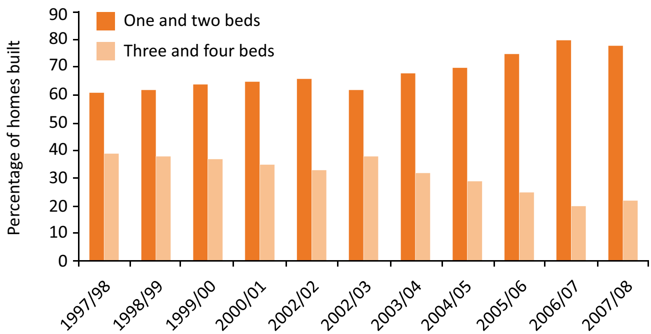


Overcrowding: Overcrowding is a problem which can have serious health, education and other social costs.[96] Overcrowding has a specific statutory meaning. Social housing tenants suffer overcrowding at more than double the rate of England as a whole and three and half times the rate of in owner occupation.[97] In London the situation is much worse than the national position with the rate of overcrowding in social housing – five times the average overcrowded rate for England and double the rate of overcrowding for social housing as a whole.[98]

More than 234,000 households in social housing do not have the minimum number of rooms to be able to house their children in a way which complies with the legal requirements. Over half of that overcrowding is in the South of England[99] and there are more than 1 million children who are living in unsuitable, overcrowded accommodation, a figure which has increased 9% in three years.[100]

The Wrong Houses: The current situation in relation to overcrowding will get worse before it gets better, particularly for social housing tenants. As outlined above, in recent years, the wrong type of social housing has been built. The dominant need within social housing is for larger bedroom houses, yet the number of three and four bedroom properties being built has declined significantly.

Figure 5.4: Housing association housebuilding 1997 onwards[101]



The rationale for the smaller unit building programme is the anticipated demographic change to more single households. However, this is a flawed policy assessment. The Barker report stated "increases in the number of households are in part the result of higher household formation rates, where people are less likely

99 http://www.communities.gov.uk/documents/housing/pdf/10.pdf

100 CLG Table 813: 1084 (2008), 983 (2006)

101 Data from CLG Table 254 Housebuilding: by bedrooms, tenure etc

to be part of a couple. But with rising incomes there is no certainty that smaller households will necessarily demand smaller houses."[102]

Reduction in social housing stock: In spite of increased waiting lists and overcrowding, the total social housing stock of the country has decreased, a decline which pre-dated the credit crunch.

Figure 5.5: Total social housing stock (in thousands)[103]

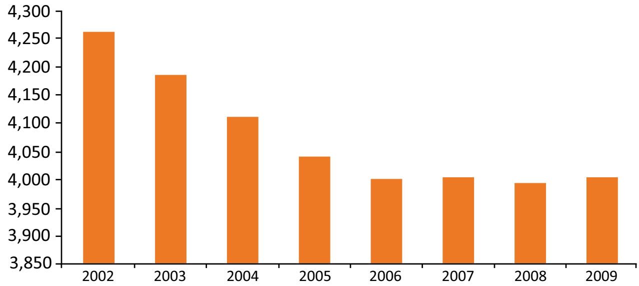


Figure 5.6: Affordable homes have increased for owner occupation and renting at levels which are higher than social renting and lower than full market rent

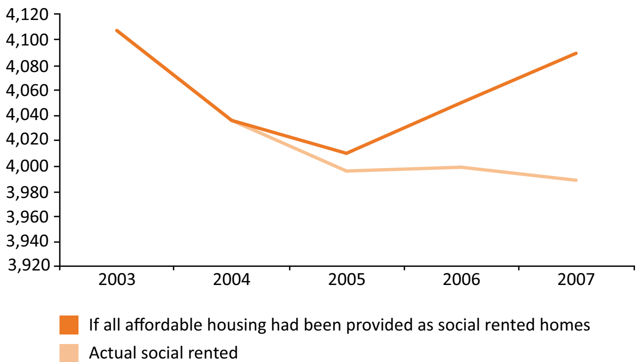
102 Barker Report, par 1.16

103 CLG Table 119

Reasons for decline in social housing stock: The marked decline in the size of the social housing sector is the result of a combination of factors: more affordable homes in total have been built but more of these homes have sold for owner occupation (on a full or shared ownership basis) and let on "affordable rent" tenancies which have higher rents and fewer protections than social tenancies. Fewer homes have been built for social rent in recent years.

In addition, the social sector loses homes each year through tenant purchase (right to buy and other schemes) and other sales; through demolition of unsuitable housing; and through changes of planning use for other purposes. It is therefore necessary to continue to build homes in order to offset the number which are lost. More than 100,000 homes have been diverted from long term social rented to other forms of affordable housing. Had those homes been provided as social rented homes the social sector decline would have been less marked and there would have been around 20,000 total homes lost rather than 250,000 homes.

Figure 5.7: Scenario showing the outcome for the social rented sector had all "affordable housing" been provided as long term social rented housing



How many more houses could be built through new sources of finance?

Taking the most conservative approach, some £30 billion of equity investment could be raised by equitising the housing associations through the newly available alternative financing models. This new equity would not be raised all in one year, or all at the same time, but gradually over time as housing associations made the transition to equity financing models. This new equity finance would replace the role of grant, and allow housing associations to build more homes with the same ratio of debt. The government's development body the HCA states that £8.4 billion of government support will deliver 155,000 new homes over 4 years (2008-2011), equal to a cost of £54,000 per unit.[104] Applying that grant ratio to the £30 billion of equity raised suggests that it would enable 555,000 homes to be developed, or more than 100,000 new homes each year between 2011 and 2016. Put another way, if equity did not provide the required investment funding, then the government would need £5.4 billion each year to fund the additional 100,000 homes per year suggested here.

The previous government had costed that a £1.5 billion grant would result in 20,000 new homes, and work for 45,000 people.[105] Such a housebuilding programme of 100,000 new homes a year would sustain around 225,000 jobs. On that basis, a housebuilding programme of 100,000 additional homes each year would require £7.5 billion of government support each year. That level of support is simply unaffordable given the dire state of the public finances.

Assuming all of the properties financed by registered social landlords remained in the social sector, and assuming another stagnant year before the housebuilding programme could be implemented, by 2016 half a million more homes could be delivered, without a penny of public funding being required.

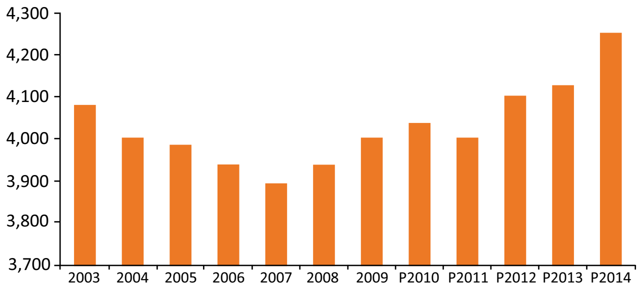
As noted above, social housing stock can be expected to reduce through sales to tenants, demolition and other reasons. Taking an

104 http://www.homesandcommunities.co.uk/national_affordable_housing_programme

105 http://www.guardian.co.uk/society/2009/sep/23/john-healey-housebuilding-revive-economy

average of the last eight year data period this is the equivalent of a reduction of around 31,000 homes each year. That could mean more than 150,000 homes are lost from the social sector over the next five years, which would reduce the size of the social sector to around 3.8 million homes. By contrast the proposals set out in this paper could result in 500,000 homes being built over the same period: a net gain of around 350,000 homes.

Figure 5.8: The number of social homes each year on a historic basis, with projections to demonstrate the effect of the housebuilding proposals contained in this paper in reversing the decline of the social sector



Re-starting stalled developments

A wider potential effect would be that private developments which are currently stalled due to the lack of funds of housing associations to acquire the social build portion could become unstalled as they have a greater availability of equity. Consequently overall more housing developments could be expected to be completed above and beyond new social housing. This would undoubtedly help to unlock the housebuilding industry.

Conclusion

Reform to the finances and operation of housing associations could make £30 billion available to build new homes over the next three years at the rate of 100,000 new homes a year. The reforms outlined in this report to achieve this are:

- A new social enterprise model for housing associations financed by equity, rather than risky debt;
- No requirement for the government to continue to provide housing grant for development, saving the taxpayer at least £5 billion a year;
- 100,000 new homes a year would spur the construction industry at a difficult time and support up to 225,000 jobs; and
- By 2016, up to 500,000 new homes could be provided, most being social homes, enabling the least well off people in Britain to be housed in line with their needs.

Housing People; Financing Housing reviews the current situation in housing and housing finance. It finds that less than 100,000 new homes are built a year, when 200,000-300,000 are needed. New mortgages are at their lowest level since 1975, while housing waiting lists have risen from 1 million in 2000, to 1.75 million today. The number of social homes has fallen 250,000 in the last eight years.

This report outlines a series of reforms to housing associations which could make £30 billion available to build 100,000 new homes a year. It proposes a new social enterprise model for housing associations, through which additional finance could be raised by equity, rather than highly leverage debt. As a result of the recommendations outlined government would no longer need to provide £5 billion housing grant each year, the construction industry would be reinvigorated and much needed new homes would be provided to house the least well off people in Britain.

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