

Section 2 Commentary

Chapter 4

Housing expenditure plans

This chapter focuses mainly on the affordable housing investment programmes of the Homes and Communities Agency (for England) and the Scottish Government. However, it also makes brief reference to future provision for social housing capital expenditure in Wales and Northern Ireland. The chapter concludes with an assessment of recent lending conditions faced by affordable housing providers.

HCA Affordable Homes Programme

As announced in July 2011, the Homes and Communities Agency's 2011-2015 Affordable Homes Programme (AHP) envisaged the construction of 80,000 'affordable homes' at a total public cost of £1.8 billions (see Commentary Chapter 4 – UKHR 2011/12). Funding is being channelled through 146 organisations selected through the HCA's pre-qualification process. While most of these are housing associations (or 'registered providers'), 15 are private developers (designated to receive 6% of total grant over the lifetime of the programme) and 26 are local authorities and ALMOs (2% of total grant).

Updated HCA figures published in June 2012 (see Table 2.4.2) suggested that the AHP could generate a significantly larger number of homes than initially projected, at a consequentially even lower grant rate. As shown in Table 2.4.1, on the basis of contracts signed with providers by this time, it appeared possible that the programme might generate over 90,000 homes over its four-year term. In interpreting these figures it should be borne in mind that they may reflect deliberate 'over-programming' and the possibly associated fact that 51 per cent of all schemes approved in the AHP funding round were 'indicative' rather than substantive (e.g. relating to unspecified sites or lacking planning permission).²

As shown in Table 2.4.2, in comparison with the three-year National Affordable Housing Programme (NAHP) running to 2010/11, the new AHP will generate just over a third of the annual output, though at only about one sixth of the annual cost in public subsidy towards initial capital costs. Consistent with these numbers, the average grant per unit for the new programme will be well under half that under NAHP, at just under £20,000. And, based on an estimated per

Table 2.4.1 HCA Affordable Homes Programme 2011-2015 (at June 2012)

	Affordable Rent			Affordable homeownership			Total programme		
	Grant (£m)	Units	Grant per unit (£)	Grant (£m)	Units	Grant per unit (£)	Grant (£m)	Units	Grant per unit (£)
London	533.6	17,492	30,500	90.9	6,380	14,200	624.5	23,872	26,200
Midlands	242.1	11,841	20,500	28.5	3,158	9,000	270.7	14,999	18,000
South & SW	203.0	10,843	18,700	30.0	3,313	9,100	233.1	14,156	16,500
East & SE	193.1	11,717	16,500	27.1	4,168	6,500	220.2	15,885	13,900
North West	166.6	8,228	20,300	14.9	1,177	12,600	181.5	9,405	19,300
NE, Yorkshire & The Humber	160.6	7,490	21,400	8.9	861	10,300	169.4	8,351	20,300
Not yet allocated	NA	NA	NA	NA	NA	NA	50.0	3,400	14,706
England	1,499.0	67,611	22,200	200.3	19,057	10,500	1,749.4	90,068	19,423

Source: *Social Housing*, November 2012 – sourced from Homes and Communities Agency¹ and Greater London Authority (unpublished). Data based on signed contracts at June 2012.

Note: 'Not yet allocated' funding and associated outputs in 'total programme' columns are not included in the 'England' totals for 'Affordable Rent' and 'Affordable homeownership'.

Table 2.4.2 Housing investment programmes in England, 2008-2015

Programme	Total dwellings approved/planned				Grant		
	Social/ affordable rent*	LCHO and other**	Total	Annual total	Total (£bn)	Annual avg (£bn)	Avg per dwelling (£)
National Affordable Housing Programme 2008/09-2010/11	93,200	80,700	173,900	57,967	8.90	2.97	51,000
Affordable Homes Programme 2011/12-2014/15 (at July 2011)	62,954	17,046	80,000	20,000	1.80	0.45	22,000
Affordable Homes Programme 2011/12-2014/15 (at June 2012)	67,611	19,057	90,068	22,517	1.75	0.44	19,423

Sources: Homes and Communities Agency (June 2012); *Social Housing*, November 2012

Notes: *Includes local authority housebuilding. **Includes NAHP Kickstart and Property/Regeneration programmes. LCHO is low-cost homeownership.

unit scheme cost of £141,000³ the average 'new programme' grant rate would equate to just 14 per cent (£20,000 as a proportion of £141,000). These are strikingly low figures compared with historic norms. Even on the most optimistic scenario, however, annual output will remain well below half of NAHP levels (see Table 2.4.2).

Key to achieving the greatly reduced grant rate and grant per unit is the Affordable Rent (AR) funding model introduced by the coalition government in 2011. By charging rents at up to 80 per cent of market levels on all newly built homes and some existing homes being relet, developing housing associations and other providers can enhance their borrowing headroom, hence reducing their call on grant subsidy.

In practice, as indicated in Table 2.4.3, providers in most regions appear to have opted to set rents somewhat short of the theoretical maximum in terms of equivalent private sector rents. This is especially evident in London where there were serious concerns that rents at 80 per cent of market levels would have been literally unaffordable due to the impact of the total benefit cap to be introduced as part of the government's welfare reform programme (see Contemporary Issues Chapter 4). The more detailed AR rent breakdown shown in Compendium Table 74d also shows that there has been a marked tendency to stipulate lower 'premiums' for larger properties.

Table 2.4.3 Affordable Rent lettings, 2011/12 – average net rents by region

Region	Average weekly rent (£)		AR as % of market
	AR	Market	
North East	86	110	78
North West	93	121	77
Yorkshire & The Humber	89	126	70
East Midlands	89	121	73
West Midlands	97	127	76
East of England	105	153	69
London	165	308	53
South East	126	192	66
South West	105	153	69
England	110	164	67

Sources: CORE lettings data; Valuation Office Agency market rents statistics.

Note: Market rent figures for year to June 2012 – selected timeframe chosen with reference to timing of AR lettings within financial year 2011/12.

Table 2.4.4 Programme funding breakdown – average unit costs for NAHP and AHP

Funding source	NAHP		AHP	
	(£)	% of total	(£)	% of total
Debt (supported from rent revenue)	61,000	39	75,000	53
Grant – programme average	60,000	39	20,000	14
Other funding (e.g. sales receipts)	34,000	22	46,000	33
Total scheme cost	155,000	100	141,000	100

Source: National Audit Office 2012 (see endnotes).

Table 2.4.5 Existing housing association properties relet on AR terms (or otherwise removed from social rent portfolio) – ratio to projected newly developed AHP homes, 2011/12-2014/15

HCA region	Projected for new development (A)	Removed from social rent portfolio				Ratio B:A
		Relet on AR terms	Discounted sale	Market sale	Total (B)	
East and South East	11,717	18,030	158	801	18,989	1.62
Midlands	11,841	12,203	232	796	13,231	1.12
South and South West	10,843	11,857	318	477	12,652	1.17
North West	8,228	17,344	99	315	17,758	2.16
North East, Yorkshire & The Humber	7,490	12,454	50	94	12,598	1.68
England (excluding London)	50,119	71,888	857	2,483	75,228	1.50

Source: HCA – as in Table 2.4.1.

Notes: 1. Comparable statistics for London not published by Greater London Authority.

2. 'Projected for new development' figures refer specifically to development for Affordable Rent.

Table 2.4.4 illustrates the extent to which, despite projecting significantly lower unit scheme costs, providers anticipate taking on significantly more debt per property under the AHP regime than was true under NAHP. Such additional debt will be supported by the higher rents to be collected under the AR regime, as discussed above. However, the additional revenue required is such that higher rents need to be charged not only on homes newly built under the programme, but also on a proportion of existing homes being relet. CORE data shows that two-thirds of the 4,600 homes let on AR terms in 2011/12 were relets of existing homes.

As shown in Table 2.4.5 it is assumed by the HCA that, over the lifetime of the AHP, some 75,000 existing homes will be removed from the social housing portfolio to underpin AR funding – equivalent to 1.5 homes for each new AR home developed under the programme. Bearing in mind current relet volumes, this will amount to around one in six homes relet during the period. Indeed some housing associations anticipate significant development volumes funded *entirely through (high) rent-supported borrowing and other association resources* (e.g. shared ownership staircasing receipts) – i.e. without any grant.⁴

However, while additional borrowing to substitute for lower grant rates may be supportable via higher rents (see above), the overall result will be to push up housing association gearing ratios, cumulatively over time – see Table 2.4.4. Cumulative impacts will create a danger of providers breaching loan covenant conditions stipulating upper limits on, for example, debt as a percentage of total net worth. Given that such a transgression would place a provider at risk of having existing loans re-priced (see below) this is clearly a critical concern. Evidently, any funding system requiring a year-on-year increase in indebtedness and gearing ratios is unsustainable in the longer term. This seems to have been conceded by government with the previous housing minister's 2011 statement that 'Beyond 2015 I would agree that [Affordable Rent] is not a model that can be repeated ...'⁵

This statement could be seen as setting the stage for even more far-reaching reforms in the medium-term future. Some even anticipate a 'no grant' future.⁶

Nevertheless, in its more recent report on the subject the National Audit Office saw the possible continuation of the AHP regime as an open question. Relevant in considering such a scenario is the observation that the £1.8 billions committed to the AHP in the period 2011/12-2014/15 period represents an 80 per cent reduction on the funding made available for the NAHP (see Table 2.4.2). This is a much larger cut than that prescribed under the 2010 Spending Review in terms of the downsizing of the overall affordable housing budget. At £4.5 billions over the four-year Spending Review period, this represented 'only' a 60 per cent reduction on previous funding levels. The explanation for this apparent paradox is that, in addition to underpinning schemes commissioned under the new AR framework, the 2011/12-2014/15 spending settlement needed to make allowance for expenditure of £2.28 billions to honour existing NAHP commitments – i.e. costs associated with the completion of pipeline projects.⁷

If extended beyond 2014/15, the AHP would be operating within a context where all existing NAHP obligations will have been extinguished. Taking this into account, and assuming the continuation of the AHP regime within a similar overall funding envelope, such a scenario could imply a substantial new increase in output. For example, let us assume that £4.08 billions (£2.28 billionss+£1.8 billions) were allocated for a renewed four-year programme for 2015/16-2018/19 – i.e. a 'standstill budget' combining the sums devoted to NAHP carryover and AHP in the 2011-12/2014/15 period. If we also assume a unit grant expenditure of £20,000, the implied four-year programme output would be 204,000 homes – or 51,000 per year (without taking account of inflation in any of these figures). Especially because of the gearing considerations discussed above, the financial feasibility of such a programme is questionable. And, in any case, continuing financial stringency may well result in further expenditure cuts. The above speculation is, nevertheless, a potentially relevant line of analysis.

At least in terms of minimising up-front capital commitment, the AHP appears to be a very good deal for the taxpayer. Putting the most favourable construction on it, the new funding formula will enable providers to stretch available resources considerably further than would previously have been possible. However, this gain comes at a considerable price. For associations, participation increases risk exposure through higher gearing ratios. As shown in Compendium Table 71a, the

value of the sector's total loan portfolio (long-term loans) had already been rising more quickly than total assets (housing properties at cost or valuation) in the years preceding the new funding regime. For tenants, higher rents deepen the poverty trap – possibly all the more galling for those paying premium rents for existing rather than newly built homes. Indeed, the new universal credit regime will result in the benefit poverty trap being extended much further up the income scales as a result of higher rents (see Contemporary Issues Chapter 4). Across the social rented housing system, the increasingly complex and incoherent pattern of rents resulting from the new regime will progressively destroy the gains hard-won through years of rent restructuring and considered essential both on equity grounds and to 'level the playing field' for the exercise of tenant choice.

It is also acknowledged by government that the higher rents incorporated within the AR model will result in increased taxpayer liabilities in terms of inflated housing benefit expenditure.⁸ A published official estimate suggests that the regime will generate additional HB costs of £1.4 billions calibrated on the basis of net present value over 30 years.⁹ On the other hand, government has previously argued that, with AR rents restrained to below local housing allowance levels, there is still a financial case for the AR model in terms of HB spending if it is assumed that those rehoused in AR tenancies are benefit-dependent tenants who would otherwise be accommodated in market rent private tenancies.¹⁰ A similar argument has been put forward in support of relaxation of rules limiting local authority debt-funded investment in new housebuilding: 'Increasing the amount of affordable or social rented housing would help reduce the housing benefit bill over time as it increases the availability of cheaper properties to rent...'¹¹

Other affordable housing investment in England

Over and above the HCA's new housebuilding plans, there is a continuing programme of upgrading existing social housing under the Decent Homes Standard(DHS) initiative. Launched in 2000, the programme aspired to bring all social housing in England up to a defined minimum standard by 2010. By 2010/11, estimated DHS investment totalled some £37 billions across all social landlords.¹² However, it was acknowledged by government in 2009 that 100 per cent DHS compliance would not be achieved by the original target date (see Commentary Chapter 2).

While scaled down substantially under the coalition government, ministers remained committed to investing a further £2 billions towards DHS refurbishment by local authorities and housing associations, over the four years to 2014/15. However, since the local authority share of this sum (£1.6 billions) was only half the estimated £3.2 billions needed to complete the programme,¹³ it appeared likely that many authorities would continue to manage non-decent stock well beyond 2015. Housing association 'gap funding' refers to government subsidy to bridge any gap between projected business plan income and expenditure of a stock transfer housing association as modelled at the time of a transfer involving non-decent properties.

As shown in Table 2.4.6, DHS investment allocated under the 2011-2015 Spending Review is heavily weighted towards London. Significant in policy terms is that almost a quarter of the 'local authority' allocations detailed here involved councils which retained direct control of their housing stock rather than having delegated this to an arms length management organisation (ALMO). The regional distribution was also influenced by the ministerial decision that assistance should be limited to authorities with more than ten per cent of their housing remaining non-decent in 2010.¹⁴

Table 2.4.6 Decent homes programme allocations, 2011/12-2014/15

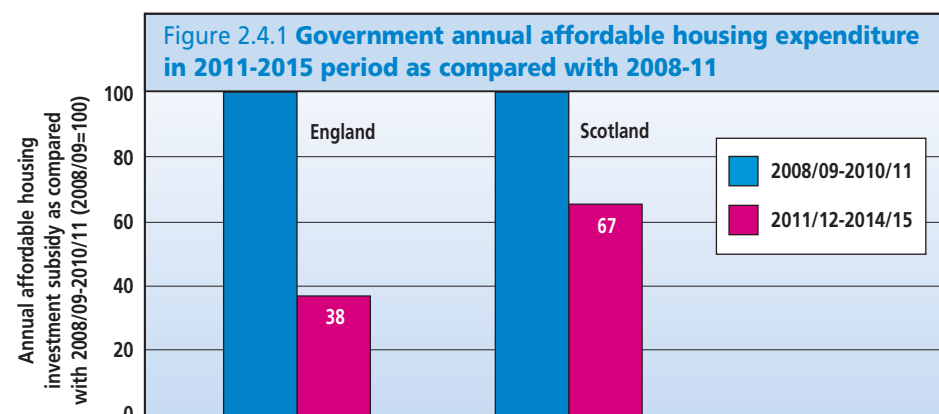
Region	LA	HA ('gap funding')	Total	% of total
East of England	98	0	98	5
East Midlands	242	8	250	12
London	821	34	855	42
North East	141	44	185	9
North West	111	237	348	17
South East	30	0	30	1
South West	32	111	143	7
West Midlands	71	0	71	3
Yorkshire & The Humber	49	30	79	4
England	1,595	465	2,060	100

Source: HCA.

There is further discussion of the DHS programme both in Commentary Chapter 2 and in Contemporary Issues Chapter 1, which considers the impact and potential of the new self-financing regime for English local authorities.

Affordable housing investment in Scotland

Consistent with UK government spending cuts, Scotland is also entering a period of greatly reduced public investment in affordable housing. As in England, temporary stimulus spending pushed housing association investment to a peak in 2009/10. By 2011/12, however, housing association funding had fallen back by 53 per cent.¹⁵ Nevertheless, the big picture here – as highlighted by Figure 2.4.1 – is that the Scottish Government has protected affordable housing investment to a much greater extent than has been true of its Westminster counterpart. In England, the £4.5 billions allocated for the period 2011/12-2014/15¹⁶ may be compared directly with the £8.9 billions dedicated to the previous National Affordable Homes Programme¹⁷ – allowing for the fact that the latter covers a four year period, while the former was a three year package. However, while the Scottish Government's annual housing, regeneration and related budget allocations for the period 2008/09-2010/11 averaged £666 millions, the comparable budgeted figure for 2011/12-2014/15 is £448 millions. Thus, while England has seen a 62 per cent cut, the comparable figure for Scotland is only 33 per cent.



Sources: National Audit Office, HCA, Social Housing, Scottish Government.

Notes: 1. 2011/12-2014/15 figures make no allowance for 2012 Autumn Statement supplementary allocations. 2. Comparison relates to 'cash' not real terms figures. 3. Scottish figures include both the Housing and Regeneration budget and the 'TMDF' government housing capital subsidy channelled through the Local Government budget.

Table 2.4.7 Scottish Government Housing and Regeneration Spending Plans to 2014/15

Programme	2011/12	2012/13	2013/14	2014/15	2012/13-2014/15
	SBR £m	ABR £m	Draft budget £m	Plans £m	Total £m
Affordable housing supply	–	226	146	–	–
Regeneration programmes	–	41	27	–	–
Supporting economic growth/housing supply	273	267	173	170	609
Fuel poverty/domestic energy/climate change	–	68	65	–	–
Grant commitments to stock transfer landlords	–	48	49	–	–
Supporting sustainability	87	116	114	95	325
Adaptations	–	6	6	–	–
Homeowners' support fund	–	10	0	–	–
Provision for regeneration	–	8	8	–	–
Housing support	–	8	8	–	–
Supporting transitions	61	32	22	22	76
Income	- 20	- 5	- 5	- 5	- 15
Total housing and regeneration budget	401	409	304	282	995
Housing supply – Edinburgh and Glasgow	98	80	73	107	260
(Housing supply – total)	–	(315)	(219)	–	–

Source: Scottish Government. Note: Homeowners' support fund included within affordable housing supply from 2013/14. A supplementary funding announcement in February 2013 added £38 millions to the overall 2013/14 housing and regeneration budget, including some £10 millions for new supply. Hence, the latter will total £229 millions rather than £219 millions as in the original draft budget.

Nevertheless – as shown in Table 2.4.7 – substantial further reductions are still in prospect in 2013/14 and 2014/15. Even allowing for the 2013/14 supplementary funding announcement (Feb 2013), next year will see a further 27 per cent cut in 'housing supply' resources (i.e. from £315 millions to £229 millions (see note to table).

Despite its much-reduced funds, the Scottish Government remains committed to 'delivering' 30,000 affordable homes in the period 2011-2015 – equating to an

Table 2.4.8 Scottish Government Affordable Housing Supply Programme new starts, 2009-2012

Type of AHSP activity	2009/10	2010/11	2011/12
New Build			
<i>Housing association new build starts</i>	6,481	4,656	2,175
new build for low-cost home ownership	738	637	157
new build for social rent	5,743	4,019	2,018
<i>Council housing new build starts (funded through AHSP)</i>	1,342	1,508	546
<i>Mid-market rent and other 'private' new build starts</i>	92	296	684
Total new build units started	7,915	6,460	3,405
Other AHSP starts			
<i>Off-the-shelf purchase starts</i>	1,660	626	230
low-cost home ownership	72	10	12
social rent	80	20	0
other	1,508	596	218
<i>Rehabilitation starts</i>	334	165	319
low-cost home ownership	9	0	0
social rent	209	142	136
other	116	23	183
<i>Home Ownership Support Fund</i>	303	374	325
Total starts – off the shelf purchase and rehabilitation	2,297	1,165	874
Total units started through all AHSP activity	10,212	7,625	4,279

Source: Scottish Government website.

annual rate of 6,000 additional dwellings. Across the five-year programme, the ministerial target stipulates that new council housing must account for at least 5,000 new dwellings. Also important here is the acknowledgement that these figures relate to completions and not approvals.

Within the context of recent activity trends (see Table 2.4.8), as well as expectations of further spending cuts, the Scottish Government's 2011-15 affordable housing supply target appears highly ambitious.

In striving to achieve the target, various strategies are coming into play:

- For housing association development, a reduction in capital grants from approximately £70,000 per dwelling to £40,000 and grant subsidy to be paid on project completion rather than in staged payments through the development period, as before.
- A (limited) shift away from social rent to mid-market rent which calls for a shallower subsidy.
- The development of new financial models.

The introduction of a *lower grant regime* for housing associations follows on from what ministers have seen as the successful post-2009 programme to kickstart council housebuilding involving grants of £30,000 per dwelling.¹⁸ As shown in Compendium Table 19e, by the end of 2011 this programme had generated nearly 3,000 new homes. In accommodating subsidy at this relatively modest level, councils have needed to draw on 'internal resources' such as municipally owned land and cross-subsidy through rent pooling. As seen from Compendium Table 82, councils have also recently stepped up their use of prudential borrowing powers (albeit that this trend will also reflect rising investment in existing council stock in the course of Scottish Housing Quality Standard property upgrade programmes).

For housing associations, however, grant benchmarks at their new levels pose major challenges. As in England (see above) this partly concerns the consequentially increased debt per unit and its impact on gearing ratios. Also, given the typically smaller size of Scottish housing associations, there is less scope for cross-subsidy from the mainstream rent base than is true for Scottish local authorities, or for typically larger English housing associations. Beyond this, recent statistical modelling has demonstrated that the scope for continued development at low grant rates is highly variable across Scotland.¹⁹ The projections, which factored in market-related rents, identified many local authority areas where grant-free or low-grant development was non-viable. Even where viability was less problematic, it was found that developing associations would be placing themselves at risk of breaching lender covenant conditions.

Notably, even at its much reduced level of £40,000, the HA grant per unit benchmark remains approximately double that factored into the Affordable Rent model in England (see Figure 2.4.1). This is consistent with the fact that, unlike their English counterparts, Scottish ministers do not favour a major departure from historic norms in terms of social rent levels.

It was expected that the new capital subsidy regime for housing associations would be made even more challenging in 2012 by the introduction of grant funding in arrears. Needing to fund the entire cost of housebuilding up-front would expose associations to increased borrowing costs, as well as significantly greater financial risk than was true historically. At least initially, however, reports suggest that some flexibility was being allowed here, perhaps in recognition of the fact that the ability to make stage payments is essential in meeting the annual spend targets which remain the discipline.

Another means of achieving lower per-dwelling grant rates for affordable housing construction has been to allow a shift in output from social rent to *mid-market rent*. Such homes are let at discounted market levels similar to those set for Affordable Rent tenancies in England. Unlike the latter, however, they are targeted towards 'low- to moderate-income' households rather than the low-income cohort traditionally accommodated in social housing. Hence, tenant selection is undertaken through a separate system from the standard needs-based housing lists used for social housing allocation.

Over and above the 'mainstream' affordable housing development programme described above, Scotland has also been developing its *National Housing Trust* (NHT) initiative, the first guarantee-based model for housing in the UK.²⁰ The NHT is a specific means of facilitating the development of mid-market rental housing. Launched in 2010 with the aim of generating up to 2,500 homes across all versions, the first phase of procurement of the original NHT model for local authorities and developers resulted in contracts being secured for over 600 dwellings. A second phase of procurement of this model was launched in 2011.

Jointly funded by participating local authorities and development partners, the original NHT model requires the establishment of Limited Liability Partnerships (LLPs), each involving a council, a developer and Scottish Futures Trust. LLPs purchase completed homes from developer partners, paying 65-70 per cent of an agreed purchase price up-front. This contribution is funded by the participating council via borrowing from the Public Works Loan Board (PWLB). The remaining 30-35 per cent of the purchase price is contributed by the developer as a mixture of loan funding and equity investment. LLP rental income supports council and developer interest payments as well as management costs for the completed homes, with the Scottish Government guaranteeing local authority PWLB capital and interest payments due in the event of any shortfall. Developer partners may trigger property sales in years 6-10 of a scheme, with the proceeds used to repay council loans and, if necessary, to recoup calls on the Scottish Government guarantee. Remaining receipts are available to the developer as repayment of equity capital (up to a capped level).

Essentially, the original NHT model for local authorities and developers moves from a traditional grant-funding approach to one based on expected future receipts from (eventual) house sales. In line with its aim to stimulate local economic development, the original model has facilitated development on some 'stalled' housing schemes where outputs had originally been intended for immediate private sale. Like 'mainstream' mid-market rent tenancies, the homes are let at 'discounted market rents' to low- to moderate-income households. Fixed-term (short assured) tenancies are in place before dwellings are sold. Tenants will be given the opportunity to purchase when the developer partner triggers the sale.

In 2012, aimed at stimulating an additional cohort of developments for completion by 2015, a housing association variant of the scheme was launched.²¹ Here, housing associations rather than local authorities will bear the development cost. Under this version of the model, however, LLPs are unnecessary. Instead, participating HAs take ownership of the homes concerned.

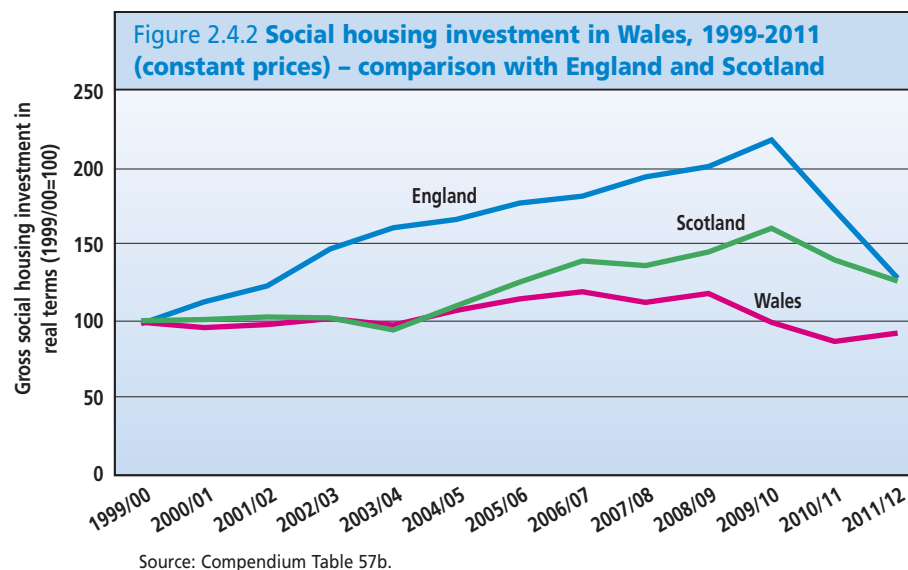
The Scottish Government reports that the NHT initiative has also inspired further innovation with specific local authorities developing derivative models.

Affordable housing investment in Wales

The pattern of affordable housing investment in Wales over the past decade has been somewhat different from that seen elsewhere in Great Britain. While the period from 2003/04 to 2008/09 saw a modest (real-terms) increase, this was far less marked than in either England or Scotland (see Figure 2.4.2). In particular, Welsh social housing investment apparently failed to benefit from the 2009/10 stimulus spending boost which pushed up expenditure elsewhere.

As in England and Scotland, however, affordable housing investment has fallen back in the most recent period. Importantly, while the Welsh Government's 2011/12 Social Housing Grant budget was boosted by a £22 millions supplementary allocation,²² this still left the total some 30 per cent down on the 2008/09 peak figure. See Figure 2.4.2.

Going forward, the Welsh Government has created a discipline for itself by committing to a medium-term target for affordable housing output. In the three years to 2015, the aim is to facilitate development of 7,500 social and



affordable dwellings (or 2,500 p.a.) This will include ‘a significant amount of social rented housing as well as homes at intermediate rent’. The target should be seen within the context of the Alan Holmans estimate of the annual national need for 4,000 additional affordable homes.²³ Equally, given that social housing completions have recently run at only around 1,000 p.a. (see Compendium Table 19d) the target looks highly ambitious. In achieving its stated objective here, the Welsh Government’s 2012 Housing White Paper²⁴ indicated support for a range of measures including:

- Reducing the social housing development grant rate – e.g. by expanding the output of homes for intermediate rent (e.g. through the Welsh Housing Partnership model).
- Accelerating publicly owned land-release and the establishment of special purpose vehicles to develop such sites.
- ‘Pioneer projects’ to expand the stock of co-operative housing.
- Development of a ‘Welsh Housing Bond’.

Housing investment in Northern Ireland

Government housing investment in Northern Ireland has fallen sharply from a 2008/09 peak. However, as shown in Figure 2.4.3, it has remained proportionately much higher than the UK-wide norm. Similarly, gross housing expenditure in 2011/12 was cut back by only 13 per cent on the previous year as compared with 20 per cent in Great Britain (see Compendium Tables 57a and 88).

As regards housing capital investment, a continuing downward trend was anticipated in the Northern Ireland Executive’s 2011 budget – see Table 2.4.9. However the negative net capital provision for NIHE still supports a modest positive level of gross investment. While investment in capital improvements to the NIHE stock fell from £11.4 millions in 2010/11 to just £8.4 millions in 2011/12, provision has been made for an increase to £12.5 millions in 2012/13. This is, however, well below the level NIHE believe they require, and only a fraction of the investment levels made in the years before 2008/09 (see Compendium Table 88). While they do have a programme to complete the provision of double glazing to all their stock by 2015, the target date for achieving the Decent Homes Standard for their whole stock is not until 2021.²⁵

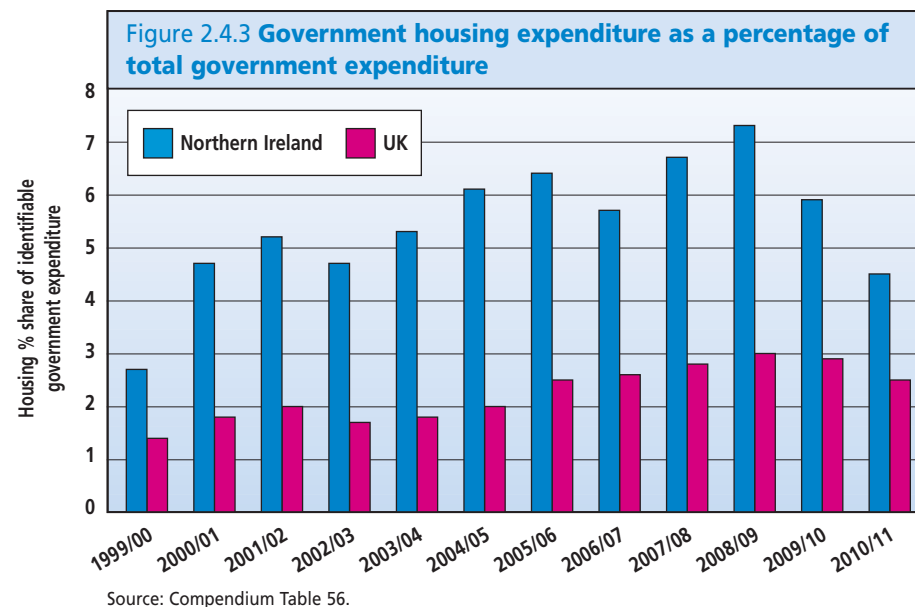


Table 2.4.9 Budgeted net housing capital investment in Northern Ireland

£m

	2011/12	2012/13	2013/14	2014/15
NI Housing Executive	- 24.3	- 32.9	- 38.6	- 30.2
Housing associations	154.4	121.7	112.6	120.2
Total	130.1	88.8	74	90

Source: Northern Ireland budget 2011-15.²⁶

However the prospects for investment in improving the NIHE stock may improve following the ministerial announcement proposing that the NIHE landlord role should be subject to a stock transfer to ‘a new landlord function out with the public sector focusing on service to tenants and enabling access to private funding to allow for suitable investment’.²⁷ There are many important issues to be resolved about the shape of the new landlord body (or bodies) but the intention is that they should be in place by March 2015.

The lending environment

As things stood in 2011/12, UK housing associations held over £50 billions in long-term loans raised to fund the construction and acquisition of the sector's 2.7 million homes.²⁸ New borrowing facilities arranged in 2011/12 are estimated by Standard & Poors as having totalled £3.5 billions. Critical to development activity going forward is the continuing availability of private finance and the terms on which this can be secured. Intensifying challenges in this area reflect both the exposed position of the major banks, due to the still-unfolding European and global debt crisis, and the Basle III measures devised to reduce banking sector risks into the future. Going forward, new risks are also emerging from government moves to cut back housing benefit (especially as regards the penalties affecting 'under-occupying' social renters as from April 2013), and the ending of housing benefit 'rent direct' with the introduction of universal credit from October 2013. With Affordable Rent levels tied to market norms, participating associations will also experience increased exposure to market volatility.

Recent years have seen the virtual disappearance of conventional, competitively priced, long-term bank finance. The cost of such finance improved steadily during the early 2000s, with typical margins over LIBOR driven down to below 25 basis points by 2007. However, the following two years saw a sharp increase to around 200 basis points, with a further increase to 250 basis points by 2012. Terms have also become significantly less attractive due to increased arrangement and non-utilisation fees as well as higher asset cover requirements. At the same time, with bank loan duration now typically set at five years (rather than the traditionally offered 30 years), the effect is to increase associations' need to hedge against re-financing risk, thereby further inflating the effective cost of such finance.

While the UK government attempted to ease access to bank lending in 2012 through its National Loan Guarantee Scheme (NLGS), any consequential benefits for housing associations were unlikely to be seen before 2013. More positively, 2012 also saw the launch of the Chancellor's Funding for Lending initiative, a Bank of England scheme to provide cheap money to banks, enabling them to avoid the need to tap capital markets with bond issuance. With investors

therefore being short of bonds to buy, associations may be able to raise funds in the securitisation market more cheaply than before.

Not only are associations facing new challenges in obtaining new finance, they are also becoming sensitised to previously unrealised risks as regards existing loan books. The underlying problem is that much of the finance secured by associations over the past decade has been provided at margins which are no longer tenable for lenders because of the much-increased cost of finance to the banks themselves. From a lender perspective, such loans are 'under water' – that is, they have become a liability rather than an asset.

In these circumstances, existing lenders have naturally been under pressure to identify loan repricing opportunities. Historically, discussion of the associated risks for housing associations tended to focus on the possible negative consequences of a landlord breaching loan covenant conditions – e.g. through exceeding a stipulated gearing ratio. However, the terms of existing loans may require lender consent for other managerial actions such as organisational reforms involving mergers or group consolidations, as well as for entering into new arrangements with other financiers. Such consent may be offered only on condition that existing loans are repriced.

One potentially important precedent established in this field in 2012 concerned a housing association which secured lender agreement for an amendment to loan conditions such that – albeit at the price of slightly more costly finance – non-cash items were discounted from covenant terms. Hence, the association was freed from risk of covenant breach associated with factors such as depreciation, impairment and other factors beyond its control.²⁹

In response to the lending conditions described above, associations have been shifting further towards capital-market bond financing, either individually through 'own-name placements' or collectively via aggregators such as The Housing Finance Corporation (THFC). Bond funding has been seen as attractive, both in terms of its potentially long-dated nature and because it has become competitive in 'cost-of-funds' terms. Consequently, as shown by the HCA's quarterly surveys,

the first half of 2012/13 saw funding from the capital markets (i.e. bonds and private placements – see below) coming to account for over three-quarters of new facilities arranged by providers in England. In Scotland and Wales, however, associations' typically smaller size makes such capital finance more problematic. While such organisations may engage in group bond issuance through an intermediary such as THFC, there are some disadvantages to such arrangements in that all participants are collectively bound to the terms of the bond – margin, length of facility and covenants.

An important implication of the switch to capital market funding is the resulting increase in the significance of credit ratings (e.g. as issued by the global agencies such as Moodys and Standard & Poors) in determining an association's prospects of securing finance on attractive terms. This also has a direct financial consequence, since credit ratings attract an initial fee estimated at £20,000, with a similar annual charge for subsequent updating.³⁰ Aggregator agencies such as THFC have their own credit ratings which depend on their reputation for the quality of their due diligence in their assessments of individual associations seeking to borrow from their public issues.

Capital market financing is not only about underwriting the cost of new investment, but increasingly a means of re-financing existing bank loans. 2012 also saw a move towards a new form of non-bank financing which has been used for both these purposes. Private placements are a form of financing positioned between conventional bank loans and bonds. While such funding is usually sourced from insurance companies or pension funds, the terms of such transactions are more akin to bank loans. Their increasing use reflects their attractiveness to organisations lacking the scale required for an own-name bond issue and discouraged from accessing such funds via an aggregator due to the inflexibilities associated with group issuance.

The combined impact of many of the factors discussed above will be to increase housing association debt capacity constraints – especially in respect of gearing thresholds. At a time when government is seeking to push associations to accommodate higher debt levels this is particularly problematic. On the other hand, it may be that associations with weaker credit ratings will be assisted by the government's housing investment guarantee scheme when this becomes operational.

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