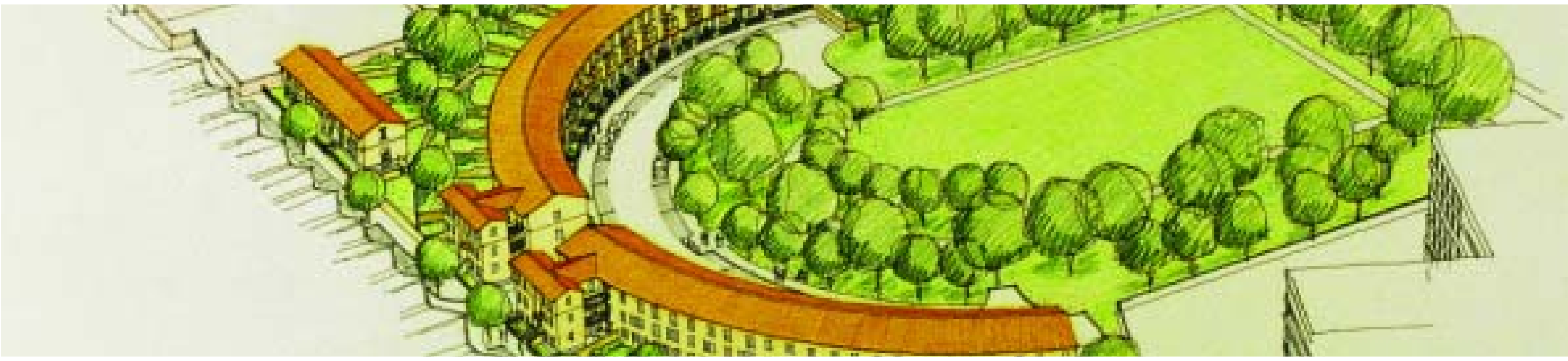
Improving social housing through transfer



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 496 Session 2002-2003: 19 March 2003

LONDON: The Stationery Office
£9.25

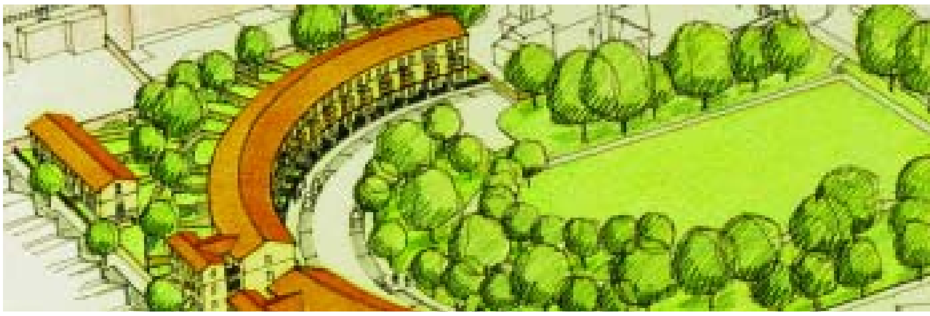
Ordered by the
House of Commons
to be printed on 17 March 2003

Summary

1 This Report focuses on two programmes for transferring social housing in England from local authorities to Registered Social Landlords (RSLs)[1]. These programmes aim to improve the condition of social housing and the quality of housing services provided to tenants. The Large Scale Voluntary Transfer (LSVT) programme started in 1988 and is still running, while transfers under the Estates Renewal Challenge Fund (ERCF) programme ran from September 1996 to March 2000. Responsibility for both programmes rests with the Office of the Deputy Prime Minister (the Office).

2 Transfer entails an RSL using private finance to buy and renovate all or some of a local authority's homes. ERCF transfers entailed the Office paying RSLs grants to compensate them for taking over homes that had negative values. By February 2003, 143 local authorities had carried out 180 transfers of a total of 738,000 homes, representing 18 per cent of the 4.2 million homes owned by local authorities at the start of the LSVT programme in 1988.

3 Our report complements the Audit Commission's report[2] on how transferring local authorities have carried out their continuing responsibilities for housing. Together, our reports provide a comprehensive assessment of the success of the LSVT and ERCF transfer programmes.



4 Successive governments have supported the policy of housing transfer[3] and the programme has been a significant plank of housing policy since its introduction in 1988, on the grounds that:

- transfer could provide an important vehicle to bring forward the improvement of sub-standard local authority housing at a time when public funding could not be made available;
- transfer was part of a wider government agenda of accessing private finance to support public services;

1 Registered Social Landlords (RSLs) are independent housing organisations registered with the Housing Corporation under the Housing Act 1996. Most RSLs are housing associations but RSLs also include trusts, co-operatives and companies.

2 Housing After Transfer (2002) - a summary of the key conclusions is at Appendix 4.

3 For example, most recently in the Housing Policy Statement 2000 "Quality and Choice: The way forward for housing" (paragraphs 4.13 to 4.20).

- transfer could bring additional benefits of greater tenant choice and participation, and of risk transfer, and therefore had the potential to be a better alternative to local authority retention even if the local authority had funds available; and
- the separation of landlord and strategic housing functions could be beneficial, and in some local authorities retention might not be desirable or feasible because of weaknesses in the management and oversight of authorities' housing departments.

Our report looks at whether transfers have delivered the intended benefits for tenants, and at the financial effects of transfer. We have not looked at the policy question of whether public funding could have been made available, or at the quality of local authorities' housing management as we are not the auditors of local authorities.

Main Findings

5 Our principal findings are:

On delivering improved services to tenants

i A key objective of the programme has been to bring in private finance to secure improvements in the quality of housing, especially by renovating stock in poor condition, and better services to tenants. Since 1988, RSLs have raised £11.6 billion of private finance, of which £5.4 billion has been used to purchase the stock. The remaining £6.2 billion represents finance which RSLs can draw on to meet future costs such as renovations as their long term improvement programmes proceed, transfer RSLs being required currently to secure 30 year funding at the time of transfer. Private finance secured through transfer was in part intended to help remedy some of the backlog of disrepair in local authority housing. The Office's English House Condition Survey of 1996 valued this backlog at £19 billion. How much of this backlog may have been tackled through transfer is not known currently. The Office's English House Condition Survey of 2001, expected to be published later this year will, however, provide an opportunity to measure the impact of transfer on the backlog of disrepair.

ii Transfers were also intended to break up local authorities' monopoly of social housing by giving tenants a choice of landlord. Transfers have reduced the proportion of social housing owned by local authorities in England from 90 per cent in 1988 to 70 per cent by 2001. In around two thirds of transfers, local authorities have sold their homes to new organisations created from the authorities' housing departments specifically to receive the stock. More generally whole stock transfers have been the primary transfer vehicle and hence the new organisations have displaced the local authority landlord as the principal supplier but without necessarily expanding choice for tenants. From the 2001 programme onwards, the Office has formally required authorities to involve tenants in the selection of a new landlord. Where a choice of new landlord is available, and could provide for an element of competition in the transfer, a key difficulty is winning the trust of tenants in respect of the different landlords to maintain tenants' overall support for transfer.

iii RSLs have largely delivered the expected benefits to tenants of better quality social housing, better housing services and opportunities for tenant participation. Our survey of RSLs, supported by audit visits, found that around 72 per cent of RSLs' homes have been improved, that almost all repairs had been made on time, and promises met on housing services. Most RSLs had kept rent increases within Housing Corporation guideline figures, and had met their promises on tenant participation. Our discussions with tenants also suggested that many considered that they had benefited from transfer. Fifteen per cent of the RSLs we surveyed said that they had not met or were delayed in meeting promises to develop new homes. Reasons included financial or regulatory problems, planning delays or insufficient grant funding from local authorities. Additionally, in some instances the promises were no longer considered appropriate because costs had increased significantly or local circumstances suggested that less social housing was needed.

iv In 2001 the Office introduced a new Public Services Agreement target to make all social housing decent by 2010, and the transfer programme is contributing towards achievement of this target. The Office undertook a survey in November 2001 of 105 transfer RSLs to assess RSLs' progress with their improvement programmes. Prior to 2001 these programmes would not have been planned in relation to the Decent Home standard. About 30 per cent of the 82 RSLs responding were likely to meet the standard within five years of transfer, and most should do so within ten years. Up to 17 per cent of transferred homes might not meet the Decent Home standard within 10 years though. Transfer RSLs are more optimistic, anticipating on average that it takes around seven years to eradicate non-decent stock. The Office and the Housing Corporation are working with local authorities and RSLs to ensure that they have suitable plans for meeting the Decent Home target over time. The standard is included in the Transfer guidelines, is reported on by RSLs, and will be included in the Office's planned monitoring and evaluation of the transfer programme.

v Local authorities and RSLs make promises about the benefits that transfers will bring to tenants. The extent and cost of these promises vary, principally because of the extensive renovation often needed to bring homes to an acceptable standard. However, promises are sometimes unclear, leaving tenants uncertain about what they can expect from transfers and hindering subsequent evaluation of RSLs' performance. While accepting the merit of clearly defined promises where possible and appropriate, the Office considers that there are situations where it is possible that the new landlord, local authority and tenants will not wish to be tied down to firm commitments or will be unable to make such commitments.

vi In our view, evaluation by the Office of the delivery of the intended benefits by individual transfers and the programme as a whole could have been more extensive as the programme developed, by greater monitoring of the outcomes achieved in individual transfers over time. In 2001, the Office commissioned consultants to develop a new monitoring system for the impact of individual transfers and an evaluation framework for assessing the overall impact of the Large Scale Voluntary Transfer programme. It expects these systems to be operational by Spring 2003 and to apply to all transfers from 2001 onwards.

vii Most RSLs have established sound finances after transfer. A small proportion have, however, experienced financial difficulties and a very few RSLs have had to merge with other more viable RSLs to overcome significant financial problems.

On the financial effects of transfer

viii The terms on which a transfer is made to an RSL are intended to be cost neutral (i.e. to generate neither a surplus nor a loss) for the RSL but this may not be achievable in practice. The Office and local authorities use a model agreed with HM Treasury to inform negotiations over the transfer value. This value, known as Tenanted Market Value, is usually less than the open market value reflecting, appropriately, the intended continued use of the properties for social housing rather than the most profitable alternative use. The Tenanted Market Value is calculated as the net present value of the RSLs' projected stream of income from renting out the transfer stock, less its expenditure stream. We found, however, that the model uses a fixed time period of 30 years whereas property lives vary, and the discount rate used in the model has been higher than RSLs' cost of capital.

ix In our view, the fixed parameters within the transfer valuation model mean that cost neutrality is unlikely to be achieved in practice, and may increase the taxpayers' contribution beyond that intended to reflect the cost of bringing properties up to an appropriate standard. Property lives and the discount rate can have a significant impact on the potential transfer value. Using data for our eight LSVT case studies, for example, we estimated that if the life of properties had been assessed as 40 years the potential transfer value would have increased by £51 million (14 per cent) compared with the actual transfer price of £356 million. The case study RSLs all considered that their transferred stock would have a value 30 years after transfer, in part because of the better repairs and maintenance associated with transfers. They also expected higher surpluses after 30 years, even after allowing for the costs of renewal programmes. Similarly, we calculated the potential transfer value of one of our case study transfers would have been £27.5 million (53 per cent) higher using the real cost of capital compared to the actual transfer price of £51.9 million. Whilst we acknowledge the Office's view that there is no evidence that higher prices would have been achievable had they been sought in these transfers, these illustrative calculations demonstrate that cost neutrality may not be achievable in practice, particularly where key parameters are fixed and are not adapted to take account of the circumstances of each potential transfer.

x In the cases we examined, we found that post transfer events had an impact on the cost neutral position intended at transfer. Some changes reflected the difference between actual performance and that forecast at the time of transfer, and reflected the risk transfer inherent in the programme. For example, renovations cost more or less than planned, demand was lower or higher than expected, or rent regimes changed. But other impacts reflected events such as the refinancing of loans by RSLs after transfer, the sale of property under the Right To Buy scheme, or the sale or redevelopment of land after transfer. We found that the possibility of these more foreseeable events occurring was not always recognised in the transfer terms.

xi RSLs are independent, not-for-profit organisations set up to meet the needs of their tenants and the local communities which they serve. RSLs do not distribute any dividends. When a new RSL registers with the Housing Corporation, the Corporation requires that its principal object must be to provide social rental housing, which must account for at least 50 per cent of the RSL's activity. Up to 49 per cent of an RSL's activities may be in non-social housing areas. In the cases we examined these uses included student accommodation, key worker homes or assisting other housing needs, or they may be market renting or wider regeneration projects. Cost neutrality in the transfer value is difficult to achieve in practice, as noted above, and in our view the Office and Corporation should look to increase their influence over how any surpluses are used, however, to encourage their application to further social housing objectives or those designed to develop sustainable communities.

xii The Office calculated the Public Sector Borrowing Requirement impacts of individual transfers and the programme as a whole, but not the actual cost to the taxpayer of the transfer of the 738,000 homes covered by LSVT and ERCF transfers up to February 2003[4]. However, at various times the Office has estimated the cost of future transfers. For example, in 2001 the Office estimated that continuation of the LSVT programme would cost the taxpayer £4,200 a home, spread over 30 years, which is £1,300 a home more than the equivalent renovation under local authority ownership if that were feasible. In terms of the potential total costs, in 2001 the Office estimated that the transfer of a million homes over 5 years would cost the taxpayer £4.2 billion spread over 30 years. The Office considers that the additional financial cost of transfer over local authority renovation has delivered non quantifiable benefits such as earlier improvement of poor condition social housing, community regeneration and increased tenant participation, and achieved risk transfer, including risks relating to income and cost, maintenance and risks arising from shortfalls in demand. It also considers the additional financial cost to be small in the context of over £15 billion allocated to housing expenditure in the same 5-year period 2001-02 to 2005-06. As our report shows, the programme has been largely successful in delivering improvements in services to tenants and in transferring the financial risks in holding properties for letting.

xiii HM Treasury has recently revised its guidance on financial appraisals, including the recommended discount rate which is now 3.5 per cent. The Office is currently considering the impact of these changes on its appraisal of the transfer programme, including any adjustments which might be necessary in valuing costs and benefits to take account of optimism bias[5] and risk transfer as set out in the Treasury guidance. The lower discount rate will increase further the difference between the financial costs of transfer to an RSL and those of local authority retention and renovation, but this increase may be offset by adjustments necessary to reflect optimism bias and risk transfer.

4 *For an explanation of the difference between PSBR effect and the real cost to the taxpayer, see paragraph 3.31 and Appendix 1.*

5 *Optimism bias represents the tendency for over-optimism in the appraisal of the outcome of projects.*

Recommendations

6 The Office's role is to assess applications from local authorities for a place on the transfer programme, examine the calculation of the transfer price and review consultation documents before they are sent to tenants. The Office also makes recommendations to the Secretary of State as to whether consent for transfer should be given. The Housing Corporation reviews prospective transfer RSLs' business plans, governance, management and staffing arrangements, and if satisfied registers the RSL. The Corporation is also responsible for the ongoing regulation of transfer RSLs' financial and operational performance.

7 On the basis of our report, we make the following recommendations. The Office should:

i Unless there are clear reasons why such definition is undesirable, require that all promises to tenants are clearly defined, measurable and time-related, including an explicit promise to meet the Decent Homes standard in a reasonable timescale. Where promises need to be changed, tenants' organisations or those tenants directly affected should be consulted and the Office or the Corporation should monitor changes to ensure taxpayers and tenants continue to receive at least the value for money intended originally.

ii Examine local authorities' option appraisals and satisfy itself that the authorities have assessed properly all options for improving their housing and services to tenants. The Office should provide guidance on how a new model should be used by local authorities and central government to assess value for money. The National Audit Office would be content to review and comment on any model as it is developed.

iii Continue its efforts to extend the range of choice of landlord, to achieve the best transfer terms for tenants at a reasonable price. The Office should explore further how greater choice and competition can be brought to bear without undermining tenant support where transfer offers the best option. Where a transfer has gone ahead successfully with choice or competition, the Office should identify and disseminate good practice, particularly on how to handle tenants' concerns. Consideration should be given to the possibility of competition to help determine the transfer value received by the local authority, particularly where receipts may not be sufficient to pay off related local authority borrowing, leaving overhanging debt and any early redemption penalties to be repaid by the Office.

iv Allow greater flexibility in determining the transfer price, to reflect a range of property lives and discount rates, taking greater account of the nature of the stock to be transferred and the likely cost of finance. In this way a range of possible transfer values could be derived, to inform the local authorities' negotiations of transfer prices and to get closer to the cost neutral outcome intended at transfer. Valuations and prices in this wider range could be compared to the value derived from the Office's fixed model and justified before transfer proceeds.

v To assist in this process of transfer valuation, commission a review of a sample of past transfer RSLs' finances, to assess the extent to which transfer assumptions have proved realistic and the transfer valuation robust, the lessons to be learned for transfer valuations in future, and the implications for policy relating to post-transfer gains and losses where these are significant.

vi Check that transfer terms take account of all assets that RSLs receive from local authorities, including receipts from Right To Buy sales and disposals of land for development.

vii Post transfer events (including the refinancing of loans by RSLs), and risks inherent in any model producing values based on forecasts, can impact on the cost neutrality intended in the transfer price. The Office and the Corporation should look to influence the use by RSLs of additional surpluses arising, if any, to encourage their application into further social housing development, other stock transfers or objectives designed to develop sustainable communities, such as key worker homes.

viii At present, before transfer, the Housing Corporation review the RSL's business plan to consider the financial viability of the RSL. The Office should seek formal confirmation from the Corporation that the assumptions underlying the transfer price are realistic, and neither too optimistic nor too conservative.

Part 1

Introduction

Background

1.1 This Report focuses on two programmes for transferring social housing[6] in England from local authorities to Registered Social Landlords (RSLs). These programmes aim to improve the condition of social housing and the quality of housing services provided to tenants. The Large Scale Voluntary Transfer (LSVT) programme, the larger of the two programmes, started in 1988 and is still running, while transfers under the Estates Renewal Challenge Fund (ERCF) programme ran from September 1996 to March 2000. Both programmes were set up by the then-Department of the Environment, and responsibility now rests with the Office of the Deputy Prime Minister (the Office).

1.2 Transfer entails an RSL using private finance to buy a local authority's homes, with the authority then using the capital receipt to pay off any housing debts and any levy due to the Office. The authority may then use any monies left over for any purposes it sees fit. Where the transfer receipt is less than an authority's housing debts, the Office pays off such "overhanging debt" and any early redemption penalties. ERCF transfers entailed the Office paying grants to RSLs mainly as dowries, to compensate them for taking over homes that were typically on run-down, urban estates and that had negative values. Grants totalled £523 million.

1.3 The number of homes transferred has grown considerably since the programmes began, with the most rapid growth occurring in recent years **(Figure 1 overleaf)**. By February 2003, 738,000 homes had been transferred - over 90 per cent under the LSVT programme - representing 18 per cent of the 4.2 million homes owned by local authorities at the start of the LSVT programme in 1988. There have been 180 transfers to RSLs across 143 local authorities[7], some authorities carrying out more than one transfer by selling off their stock in parts.

1.4 Although transfers have taken place across England, most early transfers were in the southern half of the country **(Figure 2 on page 11)** and fewer transfers have been in urban areas. However, the Office expects that an increasing proportion of the housing transferred in future will be relatively poor condition homes in urban areas. Transfers have provided the opportunity for tenants to vote on whether to have the local authority or an RSL as their landlord. Tenants have chosen to transfer rather than remain with their local authority in all but 46 of the proposed transfers. The largest transfer to date was Sunderland City Council's transfer of 36,356 homes in 2001. An even larger transfer, of 84,000 homes in Birmingham, was proposed but failed at a ballot in April 2002.

Why housing is transferred

1.5 Local authorities initiated the first transfers to take advantage of new powers provided under the Housing Acts 1985 and 1988, which allowed them to dispose of their housing and use the capital receipts for a variety of purposes, including funding the development of new housing and other capital works projects. Since April 2000, the Office has regarded transfer as making a major contribution towards achieving the Decent Homes standard[8] in all social housing by 2010 by bringing in private investment to help tackle the £19 billion backlog of disrepair in local authority housing that had been identified by the Office's English House Condition Survey of 1996. The rationale for transfers and how they should provide value for money are set out in **Figure 3 on page 12**.

6 *Social housing is affordable housing provided by local authorities and Registered Social Landlords for people who do not aspire, or cannot afford, to own or rent a home in the private sector.*

7 *On its Internet website, the Office maintains a list of all transfers of more than 500 homes at www.housing.odpm.gov.uk/transfers/download/lsvts.xls and a list of all ERCF transfers at www.housing.odpm.gov.uk/transfers/ercf/table.htm.*

8 *A Decent Home satisfies the following criteria: meets the minimum standards of the Housing Act 1985, is in a reasonable state of repair, has reasonably modern facilities, and provides a reasonable level of warmth.*