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Financial viability of the social housing sector: introducing the Affordable Homes Programme

Key facts

£1.8bn	80,000	60%
funding available for the Affordable Homes Programme	expected number of new homes to be built by 2015 as a result of affordable rent and affordable home ownership funding	reduction in average annual spending on affordable homes 2011-12 to 2014-15 compared to 2008-09 to 2010-11

377 Registered Providers that bid for funding through the Programme, either as sole applicants or as part of a consortium. Registered Providers are private, usually not-for-profit organisations established for the purpose of providing social housing

2.5 million homes owned by large Registered Providers as of March 2011 (large Registered Providers are those managing at least 1,000 homes)

£109 billion the book value of assets owned by large Registered Providers as of March 2011

£10 billion the net amount that large Registered Providers earned in rents in 2010-11

Summary

1 In 2010, the government announced a new programme to build affordable (which the Department defines as below market price) housing in England – the Affordable Homes Programme (the Programme). The Programme is expected to contribute approximately 80,000 homes through affordable rent and affordable home ownership in the four years from April 2011. Affordable rent is a new funding model, which involves three main changes: housing providers can charge higher rents for affordable housing than previously (up to 80 per cent of market rates), both for new homes and for some new tenancies of existing homes; housing providers finance a greater proportion of the cost of new homes themselves, through increased borrowing; and the Department pays less grant for each new home provided.

2 The Department for Communities and Local Government (the Department); the Homes and Communities Agency (the Agency); and, until March 2012, when its role was taken on by the Agency, the Tenant Services Authority (the regulator) have all helped to develop the Programme. The Programme is delivered through housing providers, who during 2011 could bid to the Agency to get Programme funding. There are three main types of housing provider:

- private Registered Providers, many of which are housing associations, are usually not-for-profit organisations established to provide social housing;
- local authorities; and
- arm's-length management organisations, which are companies set up by local authorities to manage all or part of their housing.

Since April 2012, the Greater London Authority has taken on the Agency's housing and regeneration activities across London.

3 The Programme is intended to build housing with a third of the grant per home of earlier affordable housing schemes. It will involve housing providers spending some £12 billion on new homes, funded by a combination of government grant (£1.8 billion), borrowing by providers supported by rents on the new properties (we estimate around £6 billion), and funding from other sources (about £4 billion). Rents totalling around £500 million a year on new homes will be paid by tenants, approximately two-thirds of whom are supported by housing benefit.

4 The Programme increases the risks providers must manage. These risks include providers' increased borrowing and exposure to the housing market; delivery risks resulting from the commitments they are making to deliver new homes over the period of the Programme; and understanding, and dealing with, the impact of changes to benefit rules. Therefore, to be successful, the Programme must help housing providers to best use the funds available to them, including borrowing, without over-stretching themselves or risking their financial viability. This report examines whether, in developing and starting to deliver the Programme, the Department, the Agency and the regulator are addressing effectively risks to housing providers' financial viability while achieving policy objectives. We have focused on the new affordable rent model, which accounts for the majority of new funding available through the Programme.

Key findings

The Department's Programme design

5 The Department's analysis of its options for the Programme used a consistent modelling methodology and set of assumptions. The Department had £1.8 billion available between 2010-11 and 2014-15 for grants to housing providers and carried out a cost–benefit analysis of three different options to spend this money. The analysis considered costs to government and benefits to society. The Department carried out a separate exercise to better understand the costs to housing providers, although this evidence was not included within the impact assessment. The Department took into account total costs and benefits to all tenants, including those who would not have all their rent paid by housing benefit. However, the published analysis did not state the number of tenants in this group who would be affected by different amounts, or assess the effects on individual tenants' incomes.

6 The Department selected the best delivery model open to it for the funds it had available. Continuing with the previous programme's funding model offered potentially better value for money over the 30-year costing period. We estimated that some 8,200 homes could be funded at the same total cost over 30 years. However, such a programme would also require more grant funding than was available. Instead the Department chose the option that maximised benefits and the number of homes it could deliver within the £1.8 billion grant funding.

7 The Department has so far achieved its policy objective to maximise the number of homes delivered within the available grant funding. On average, the grant awarded per home is a third of previous programmes. The final grant per home was approximately £20,000 compared with £60,000 under the previous National Affordable Housing Programme. The lower grant has been achieved partly through the higher rents providers expect to charge. The Department estimates that over 30 years these will result in increased housing benefit costs with a net present value of £1.4 billion, or approximately £17,500 per home.

8 **The Programme was oversubscribed which led to the Department raising its target for the number of affordable homes it expects to deliver.** The amount of funding bid for as part of the initial application process was double that available and the number of homes offered exceeded expectations by even more. Because of the better-than-expected offers from providers, the Department and the Agency agreed in principle with providers delivering some 80,000 homes compared to its initial target of 56,000.

The Agency's appraisal and selection of offers

9 **The Agency's final decision-making process took account of a range of factors but not in any set weighting, so we could not repeat its work to test it. Benchmarking against previous programmes would have increased the Agency's ability to test the value for money of the proposals, which might have reduced the grant per home offered.** Some 55 successful offers had grant levels that were below the average grant per home, compared to one unsuccessful offer. The Agency considered a number of different factors when assessing bids, but the grant per home was the key driver. The number of homes offered by providers afforded some scope for competition: because offers exceeded expectations the Agency could choose between providers and encourage providers to resubmit offers so as to reduce the amount of grant required. As a result, the Agency was able to reduce the grant per home from an average of around £22,000 in providers' initial bids to around £20,000. However, its final decision-making process was not fully prescribed so we could not repeat the process to see how the Agency made individual decisions, or whether it could have secured better value for money. The Agency might have further reduced the grant per home offered if it had drawn on benchmarks of cost per home from previous programmes.

10 **Risks to meeting Programme aims remain.** As at April 2012, 82 per cent of contracts had been signed. Most of the contracts that had not been signed were with local authorities who had been delaying signing contracts pending confirmation of final borrowing capacity arising from the changes to the Housing Revenue Account in April 2012. More than half the homes expected to be built under the Programme are currently planned for its final year, so slippage would put at risk achievement, within the period of the Programme, of the planned 80,000 homes. In addition, some providers in London have concerns they may not be able to charge rents at the levels they originally agreed. The Agency recognises that meeting the March 2015 deadline is a key risk, and has put in place a regime to monitor providers' progress. The Greater London Authority is also aware of this issue and is in discussion with providers and local authorities over it.

The regulator's assessment of the financial viability of Registered Providers

11 **The Department modelled the impact of the Programme on Registered Providers and concluded that they had the financial capacity to invest more of their own resources to deliver affordable housing.** Before the Programme, those Registered Providers managing or owning more than 1,000 homes experienced growth between 2008-09 and 2010-11 in both turnover and surpluses. Surpluses increased by 80 per cent to £1.1 billion in 2010-11 from the previous year on turnover of £12.6 billion (an increase of 9 per cent between 2008-09 and 2010-11).

12 **The Programme increases providers' financial exposure.** The sector faces challenges in getting bank financing for capital investment, and the cost of supporting both existing and future debt. Between 2008-09 and 2010-11, most Registered Providers have benefited from recent lower interest rates, so while total debt increased by 12 per cent to £45 billion, interest costs only rose by 3 per cent to £1.9 billion. However, some have had to offer additional collateral, generally in the form of assets rather than cash, to lenders because of using financial derivatives to reduce their interest rate risk. A survey by Baker Tilly in 2012 found that 63 per cent of Registered Providers who responded are now considering alternative funding other than traditional banking sources, the most popular being corporate bonds. Five of the ten biggest Registered Providers have issued bonds between August 2010 and April 2012; rates for recent issues have ranged from below 5 per cent to 5.36 per cent.

13 **The regulator undertook analysis to identify any increased financial exposure for those Registered Providers that applied for funding.** It looked at whether the proposed delivery commitments increased Providers' exposure beyond that already understood by its ongoing regulatory work. The regulator highlighted particular risks to the financial viability of six Registered Providers, around the robustness of assumptions made when putting their offer together, and the potential impact of the wider economy. To address these risks, the regulator carried out additional work, after which it concluded that all Registered Providers submitting offers were financially viable and would continue to be so, subject to their managing specific risks identified.

14 **The Department will need to carry out a thorough analysis of the financial position of providers to assess the repeatability of the affordable rent model after 2015.** The issues to be considered include the effect of the economic climate on housing providers, the ability of providers to borrow additional capital funds, the amount of interest for a further iteration of the Programme, and the willingness of the sector to take on even more risk than it has already.

Conclusion on value for money

15 The Department and the Agency selected a design for the Programme that is projected to maximise benefits and the number of homes delivered within the constraints of the £1.8 billion capital funding available. The launch of the Programme has been successful. Providers have committed to building some 80,000 homes for the £1.8 billion of government investment, approximately 24,000 more homes than first expected. In this respect, the Programme has made a good start.

16 However, key risks remain and the delivery of new homes is concentrated towards the end of the period covered by the Programme. The final judgement of the value for money of the Programme will therefore depend on how successful the Department and the Agency are between now and 2015 in managing these risks and securing delivery of the aims of the Programme.

Recommendations

17 Our recommendations are designed to help the Department secure value for money from the Affordable Homes Programme, and draw out lessons for future housing programmes.

For those implementing the Affordable Homes Programme

a **The Department should update its assessment of the estimated costs and benefits of the Programme regularly so that progress against the initial assessment can be monitored, costs managed and understood, and benefits maximised.** Risks to meeting Programme aims remain, and regular updating of the assessment would assist the Department in managing them.

b **To understand the impact of transferring financial and delivery risks to providers, the Agency should evaluate how far providers priced risks into their offers, and whether the price paid represents value for money.** The Department concluded Registered Providers had the financial capacity to invest more of their own resources into affordable housing. However, the Programme increases the risks providers must manage, including financial exposure and challenges in getting bank financing for capital investment.

c **The Department and the Agency should evaluate the impact of the Programme on successful providers, and establish the reasons why they offered as many homes as they did, and why some providers did not apply, or were unsuccessful.** The Department concluded that Registered Providers had the financial capacity to invest more of their own resources to deliver affordable housing, but, following consultation with the Department and the Agency, provider's offers substantially exceeded its expectations. Establishing the reasons for providers' differing responses to the Programme will help secure successful delivery and design of future programmes.

For those implementing future programmes

d **For future programmes, the Department and the Agency should use the cost information from the Programme to seek additional savings in the cost per home. The Agency should also consider how to use competition further, by evaluating opportunities to use alternative bidding methods such as multiple rounds or open bidding.** Where possible, making greater use of benchmarks on cost per home from previous programmes would strengthen the Agency's ability to test the value for money of proposals. The Agency applied some degree of competition to achieve savings but it might have further reduced the grant per home offered by housing providers if it had more systematically assessed whether offers were competitive.

e **The Agency should consider the benefits of designing a more structured decision-making process which can be replicated, so that any future Programme can benefit from previous 'tried and tested' approaches.** The Agency examined a range of factors when assessing applications for funding. The application process was conducted systematically, but because set weightings were not given to each factor we could not repeat the process to see how decisions were made.