social hearted, commercially minded

a report on tomorrow's housing associations

By Denise Chevin

THE SMITH INSTITUTE

Genesis

The Genesis Narrative

Genesis combines its social purpose – helping our customers build better futures – with a commercial approach geared to filling gaps in dysfunctional housing markets and creating value in the properties we own and the places in which we operate. Our innovative approach means that we offer a wide range of tenures, products and services which are aimed at helping our customers meet their housing aspirations as they evolve and their circumstances change over time. We recognise the value and importance of strategic alliances, working closely with local authorities and other partners in our key areas of operation – London, Hertfordshire and East Anglia.

Our range of customers and their expectations will become more diverse over time. We aim to be an agile organisation using our customer knowledge to align our products and services and the standards to which we deliver them, so that our customers trust us, want to stay with us and recommend us to others. Providing more opportunities for customers to self-serve on transactional services will help deliver expectations of "instant" service delivery.

Our customer base includes many households facing severe challenges, some financial, others because of illness or disability. We will continue to provide a range of support to our most vulnerable customers to enable them to sustain their homes. For other customers we intend to adopt a new approach aimed at helping to shift behaviours and expectations from dependency to independence.

With our charitable foundation Genesis Community we support and indeed act as a social enterprise, working with community groups to shape the places in which we have homes – either through development and the management of existing properties or through our regeneration activities and to enhance the sustainability of those communities.

Given the current and likely to be enduring shortage of public funding for new housing, we consider that an increased focus on providing intermediate and market-based products, such as shared ownership, shared equity, intermediate rent, market rent and outright sales, is important in meeting today's housing problems as well as potentially providing resources for the development of our more traditional social housing. We recognise that as an independent modern organisation we should be less reliant on increasingly scarce government funding and more self-sufficient, looking to see how we can use the value within our existing portfolio to meet our objectives. In this way Genesis aims to be a leading property-based service provider within the areas in which we operate.

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Foreword
Neil Hadden, Chief Executive of Genesis

As will be seen from the contents of this report, the world in which housing associations operate is subject to far-reaching and rapid change. We need to evolve to cope with these changes if we are to survive and thrive. The question is, what will that evolution look like?

At Genesis we have been on a journey of transformation for the last two years. We collapsed our group structure by effecting an amalgamation of our four main registered associations in April 2011. Since then our focus has been on creating a modern, agile, effective and efficient organisation providing first-class services to a wide range of customers. It is not easy: there is a lot of history and emotional attachment to the traditional housing association model, but we cannot continue to look backwards; we need to look ahead and think what we need to be and do in the next decade.

Alongside our transformation journey we have been developing our narrative. What is Genesis for? What does it do? Why do people work here? As we explain in the statement on the inside cover, it will change, as our customers' needs change, as our stakeholders' views of our role change, and as we change ourselves to cope with the future.

I hope this report provides food for thought and helps to shape a debate that needs to be had if we are to remain relevant and continue to make a contribution to addressing the nation's housing issues.

Preface

Paul Hackett, Director of the Smith Institute

In February 2008, just months before the financial crisis took hold, I chaired a Smith Institute debate on the future of housing associations. Digging out my notes from the event, I see that despite some doom mongering the mood then was quietly optimistic. Participants talked of a "new dawn" and how different funding models would boost the supply of affordable homes and offset any cuts in public investment. Housing associations would, said one speaker, no longer be the "lions that didn't roar".

Five years on, such comments seem from another time, when prolonged fiscal consolidation was not even on the agenda. Although the recent falls in affordable housing starts have been nothing like as severe as for private house building, the housing market today remains depressed. There has not been the growth in social housing that was hoped for, despite strong demand in London and the South East. As this report shows, housing associations have had to rethink their plans and adapt to changing and more risky circumstances.

The future for the affordable housing sector is still far from certain, and few associations in London and the South expect a return to the status quo ante. Many housing associations are at a crossroads and are trying to understand what lies ahead. Should they continue to provide homes for low-income households, or should they seek out new opportunities in the private rented sector and recycle their surpluses for social housing? These and other concerns about market conditions and the government's housing and welfare policies are being talked about at tenant meetings and in housing association boardrooms. Against this backdrop, this report could not be more timely and relevant. We hope that at the very least it provides an insight into what the sector thinks about itself.

The Smith Institute would like to thank Denise Chevin for researching and writing the report, and Genesis Housing Association for supporting the project. We would particularly like to thank all those who gave their advice, knowledge and opinions, on which this report is based. We hope the report accurately and fairly captures people's views. The willingness of busy people to give up their time to be interviewed and attend the roundtable discussion on the future of housing associations demonstrates the commitment that is ever present across the sector. Whatever views politicians and commentators may hold about housing associations, few can doubt that those who lead the sector care passionately about its future.

Executive summary

Executive summary

The housing association landscape in London and the South East is undergoing a period of dramatic change. Reductions in capital subsidy, sweeping welfare reforms and shifts in housing policy away from the provision of traditional low-rent social housing present major challenges to the sector.

This report, based on interviews with 50 leading players in the sector, including housing association chief executives and board members, shows that:

- The sector is debating its purposes and objectives. Many associations are reviewing their strategies and business plans in order to ensure a workable balance between their social and commercial aspirations.

- The sector broadly welcomes the new freedoms it has been granted, but many associations are wary of the associated risks. There is a divergence in opinion about the pace and scale at which the sector moves from being an "administrative developer" to an "entrepreneurial developer", not least between large and small associations.

- For some associations, the growing emphasis on the commercial aspects of the business is moving the sector away from its social roots. For others it is liberating, allowing greater autonomy and more opportunity to cross-subsidise submarket rented housing.

- Opinion is divided on whether capital subsidy will return to even near previous levels. However, the general view is that there will be very little new conventional low-rent social housing without grant.

- The prospect of developing next-to-no housing at target rents is pricking the social conscience of some boards. There is a sentiment among some of the larger associations that new development for private renting should be genuinely additional, not replacing social housing at lower rents.

- Reductions in grant and bank lending have forced the sector to seek funding on the capital markets, notably in the form of bond finance. Despite concerns about the new "universal credit" combined benefit, bond financing is set to increase and there are likely to be more innovative deals with institutional investors.

- However, some associations are cautious about borrowing more. There are also worries that the shift to private finance could make it less likely that government would provide capital subsidies in the future.

- While mergers have been advocated to drive down costs, the view is that in the future these are also likely to occur in order to increase capacity for further borrowing.

- Associations are worried about universal credit and how to protect vulnerable tenants. Some are nervous about their loan covenants being affected by higher rent arrears.

- There are major concerns about the affordable rent model with many interviewees saying that rents of 60-65% of market rent, never mind 80%, are unaffordable for low income tenants.

- There are concerns over whether associations have the requisite capabilities and skills at board and management level to thrive in a more commercially minded environment, especially competing with the private rented sector.

- In their drive to become more commercial, many associations said they were seeking greater value for money and better asset management.

- In the face of fiscal austerity, associations are increasingly looking to deliver social value through community services, which can also provide an additional income stream. New partnerships are also emerging between associations and health authorities.

- Measuring social value remains problematic, and there was a call for more work in this area (including development of a new index to measure social return on investment).

- There is a widely held view that working more closely with local authorities will be key moving forward, not least over managing the impacts of welfare reforms and changes in housing policy. However, tensions are expected to arise as associations reduce development of low-cost homes and become more selective about their tenants.

- The relationship between housing associations and their tenants is also at a

- crossroads. On the one hand, all social landlords aspire to improve customer satisfaction and performance, but on the other they have tough decisions to make in order to ensure value for money and on rent levels and arrears.

- Chief executives highlight the need to adopt new strategies to engage tenants on ways of adjusting to the welfare reforms, notably around universal credit. Some associations are also offering fixed-term tenancies for new tenants as a way of raising standards and tackling antisocial behaviour.

- The general impression amongst experts and practitioners is that the sector remains resilient and is confident of seeing out the recession. What is less clear is the rate at which the sector will continue to provide housing for those on low incomes.

Scope of the report

Scope of the report

The aim of this report has been to look at the future direction of housing associations, the challenges they face and how they will develop and evolve over the next few years. Who they should house, where they should house them and how much they should charge are the sort of questions that associations are asking themselves all around the country, as they grapple with a new operating environment. This work taps into that zeitgeist, reflecting those conversations and debates and the new strategies that are emerging from them.

The report is largely based on the views of some 50 senior people drawn from across the housing association world: including chief executives, board members and senior managers, as well as developers, politicians, representatives from housing agencies, experts, advisers and commentators. Our intention was primarily to explore developments in the sector from the perspective of the housing association, rather than from the viewpoint of tenants.

Interviews were carried out by a mixture of face-to-face and over-the-phone discussions in late 2012 and early 2013. A full list of all those organisations that participated is in annex 1. The Smith Institute also gathered a number of senior practitioners together to discuss the future of housing associations at a roundtable event in November 2012.

The focus of the desk research, roundtable discussion and interviews was primarily on the prospects for housing associations operating in London and the South East, where property prices and land value make commercial development more financially viable. Reference is made to national housing and welfare policies and to other drivers of change affecting the sector, but the commentary is predominantly confined to Southern England.

The report makes no claim to provide a comprehensive analysis of what is happening to housing associations, but focuses on the key tension points and future trends. By mirroring a range of views, the report aims to help housing associations better comprehend the world around them so that they can carve out their own modus operandi and better plan ahead.

Chapter 1

Introduction: challenges ahead

Introduction: challenges ahead

In 2008 the Smith Institute looked at how housing associations were adapting to change;[1] today, the challenges facing housing associations could hardly be more different – then again, in some ways, they could not be more similar. Now, as then, there are constant pressures and problems to do with building more homes, creating communities with mixed tenures, battling against the planning system and looking for ways to forge new partnerships.

None of those challenges has gone away. Quite the opposite: they have become even more pressing. When the last report was written five years ago, it was the early days of the housing downturn, and the extent and severity of the recession and banking crisis were yet to emerge fully. Since then new housing starts have plummeted and stayed at record lows, the number of people on housing waiting lists has grown, and public investment in affordable homes has been halved. We can add to this list another depressing statistic: the use of bed-and-breakfast accommodation to house families beyond the legal time limit has risen by 800% since the Coalition took office. And yet the cuts have hardly begun to bite and there is still the prospect of billions in public spending cuts and benefit savings ahead of us.

Not only has the problem got bigger – and the better use of assets and skills in the sector become a more urgent need – but also the means of tackling it has both changed and become more diffuse. The difficulties of developing homes with little subsidy, combined with adjustment to welfare reforms and rent caps, are set to create greater financial pressures that will drive major change in housing associations.

Interviewees were confident that they could survive the storm and be all the stronger because of it. The chief executives interviewed held a common view: that the sector is resilient; that change is difficult but essential; and that associations' social ethos of providing housing for the less well-off and helping to create sustainable communities remains at the heart of what they do. Fiscal austerity is nevertheless forcing associations to scrutinise the way they work, make efficiencies and adapt to change more quickly than many would like.

As subsidies have declined, housing associations are in effect being unshackled from many of the rules and regulations that have guided them since the 1980s. For the majority of chief executives, the sector is now charting a new era of independence and self-determination.

1 Smith Institute *Moving Up a Gear: New Challenges for Housing Associations* (2008)

Briefings by the National Housing Federation show that the sector is becoming more diverse, embracing a wider community role and developing for a broad range of tenures, tenants and residents. To shared ownership, shared equity and submarket rents we can now add private rental, as the sector looks to take advantage of new government incentives and freedoms. This has been the direction of travel for some time, but the pincer movement of housing benefit caps and limited development grant (which it is anticipated could disappear altogether) have accelerated the progress of change. As one chief executive put it: "It's about being housing providers, as opposed to affordable or not. We have to accept the future without major subsidy."

Many are going on a journey of discovery and asking themselves: what is their purpose, who should they house, and where? Others are watching and waiting, while yet others are positively relishing the challenge of grasping the new opportunities. Many associations are reviewing their strategies and business plans. With government policy seeming to change on an almost daily basis, and the rules in a sense yet to be written, associations will certainly need to be fleet of foot.

However, chief executives and their boards are aware that they have to plan ahead on what they know now. Seven to ten years is not long in terms of strategy and the development cycle, so decisions taken now will very much set the road to be travelled further ahead. It is not unusual, for example, to purchase land 10 years before a scheme's projected completion date, particularly for large schemes built in several phases.

Though many housing association board members view the future with fear and trepidation – and in pockets anger and outrage – what is apparent from this study is that despite these tough times there is eagerness within some associations to make the most of newfound freedoms. This enthusiasm is accompanied in places by a wealth of new ideas and resourcefulness, not least in regard to developing new funding models and partnership working.

The overarching message from across the sector is clear: as organisations become more entrepreneurial, the risks they run increase. As a consequence, the leadership and capabilities of housing association staff will come under ever greater pressure and scrutiny.

Chapter 2

The big squeeze: understanding the drivers of change

The big squeeze: understanding the drivers of change

Sweeping policy changes and spending cuts are having a severe impact on housing associations, altering the financial models they have operated since the 1980s. The government's drive to cut the £21 billion housing benefit bill (and, as the Coalition sees it, welfare dependency) on the one side, while reducing development grant on the other, will combine to squeeze association budgets and shape their strategies going forward.

2.1 Prolonged austerity

The recessionary gloom, perhaps the worst since the 1930s, does not appear likely to lift soon. The chancellor's 2012 autumn statement extended austerity to 2018,[2] while other reports have suggested it could continue as late as 2023.[3]

The Office for Budget Responsibility forecasts that the UK economy will grow slowly over the next few years,[4] with greater concentrations of unemployment, under-employment and in-work poverty in deprived areas (including in London and the South East). This is happening at a time when the government is set to cut public spending still further. The view from the housing association world is that slow growth and prolonged austerity will inevitably place more demands on scarce resources, not least housing benefit and housing welfare. Few associations expect any sudden return to pre-recession levels of government spending.

However, the level of capital spending on housing will depend on how much of a priority it is for the next government. What seems likely to continue, whoever is in power, is pressure to reduce revenue subsidy for housing, notably via housing benefit. As David Cowans, chief executive of Places for People, points out, there are "a lot of people out there expecting some sort of normality to return. Normality won't return; we're operating now in the new normal."

2.2 Localism and flexibility

The shift in housing and regeneration policy towards greater localism and autonomy has continued under the Coalition. The Localism Act 2011, for example, ushered in wide-ranging changes that will affect the way associations operate for some time to come. Among the most significant changes are: new powers to grant fixed-term tenancies; more control over local waiting lists; reform of homelessness duties to

2 HM Treasury *Autumn Statement 2012*, Cm 8480 (December 2012)
3 Centre for Economics & Business Research
4 OBR *Economic and Fiscal Outlook*, Cm 8481 (December 2012)

allow councils to discharge homeless people into the private rented sector; greater tenant mobility across the sector; and reform of the housing revenue account system to establish a new self-financing system for council housing. Other relevant changes include the granting of new freedoms to enable associations to dispose of their stock and changes to planning law.

In addition, the sector has had to adjust to a new regulatory framework, which (under the auspices of the Homes & Communities Agency's new regulatory committee) supports the new affordable rent system and sets a new value-for-money standard focused on the efficiency and effectiveness of an association. On balance, most associations welcome the revised regulatory regime. The National Housing Federation has described the proposals as a "welcome reduction of the regulatory burden on the sector, particularly in respect of the consumer standards".[5]

2.3 Private rented sector and pressure on tenants

Increased difficulty for tenants in meeting rental payments is caused not only by the reduction of welfare support but also by falling real wages and the growth of under-employment. At the same time, social housing is likely to be in even greater demand, especially if rents in the private sector continue to rise in London and the South East.[6]

There are already nearly 2 million households on the social housing waiting list, and 483,500 of these are in London. On current trends, need will continue to increase, especially in high-demand areas. Furthermore, few in the sector believe that in the current discordant political environment the public will switch its sympathies away from home ownership and towards subsidised social housing.

The focus of investors and policy makers, at least for the short term, is likely to continue to be on the private rented sector, which as figure 1 shows has grown dramatically since 2005. According to Savills, the number of households renting privately rose from 2.6 million in 2001 to nearly 4.8 million in 2012. It estimates that by 2016 one in five households in England will be in the private rented sector, with the proportion of such tenancies in inner London boroughs rising to over 50%. Worryingly for new, younger tenants, Savills also forecasts that average rents will increase 18% by 2017, and rise even more rapidly in London and the South East.

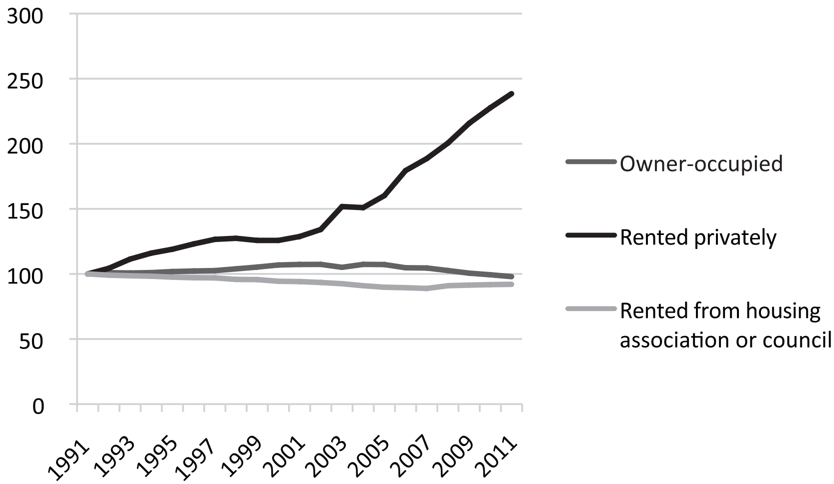
On the back of the Montague report,[7] the government is actively supporting the growth

5 National Housing Federation *Regulatory Framework from 1 April 2012*, briefing (April 2012)
6 Savills *Residential Property Focus Q4 2012* (November 2012)
7 Montague, A *Review of the Barriers to Institutional Investment in Private Rented Homes* (DCLG, August 2012)

of the private rented sector.[8] According to housing minister Mark Prisk MP, "there is real untapped potential to expand and improve the private rented sector. By bringing in large-scale investment and building more new homes specifically to rent, we can not only offer a broader choice to tenants, but set a new bar in quality for landlords, large and small, to match."[9]

Figure 1: Housing tenure in London

1991=100



Source: DCLG live table 109

Over the last few years government and the Homes & Communities Agency have actively encouraged the building of more two-bedroom properties. The net result has been a shortage of one-bedroom homes. The English Housing Survey shows that while only a third of social renting households have one bedroom, the household size of 44% of social renters is one person (and 24% among those aged under 60).[10] Several associations have pointed out that in future in high-demand areas it will therefore prove extremely difficult, if not impossible, for those of working age in properties deemed too big to be rehoused in smaller properties within the social rented sector.

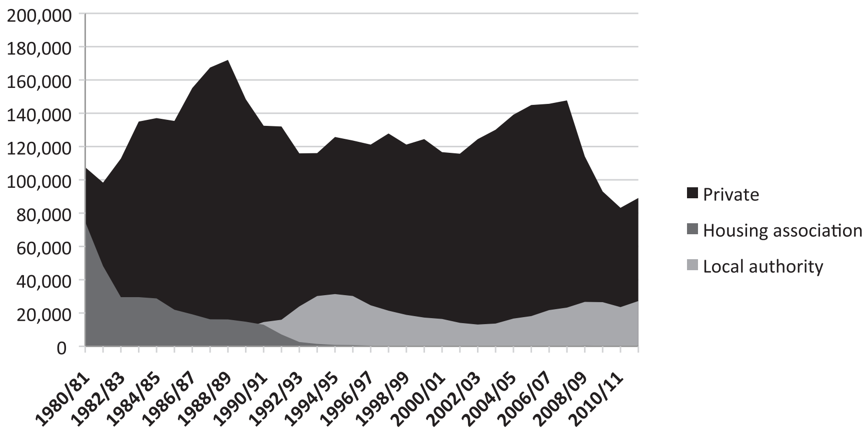
8 See 2013 Budget for details on the build-to-rent scheme and 2012 autumn statement for details on £10 billion loan guarantee scheme.
9 "Improving the PRS", housing minister Mark Prisk's blog, 6 February 2013
10 DCLG *English Housing Survey Headline Report 2011-12* (February 2013)

2.4 House building remains fragile

The economic downturn and squeeze on lending have led to a dramatic fall in house building. Housing starts in 2012 were nearly half those in 2005 – almost all of which decline can be attributed to a reduction in private house building. Completions meanwhile have fallen by a fifth over the same period.[11]

For social housing, completions dropped 7% to 34,280 in 2012, while registrations (the indicator of schemes in the pipeline) fell 28% to just 26,390. Consistently, around half of this activity in England is happening in London and the South East.

Figure 2: Completions by provider, England



Source: DCLG live table 253

House building is failing to meet growing demand and need. Local authority waiting lists remain large and household growth, especially in London, is rising rapidly. If the capital is to house the projected numbers of households then several hundred thousand new homes will need to be built over the coming 20 years. On current trends, this looks highly unlikely.

According to the G15 group of London's 15 largest housing associations,[12] there is a

11 National House Building Council *NHBC New Homes Statistics Review 2012* (January 2013)
12 G15 includes: A2 Dominion Group, Circle, Hyde Group, Notting Hill Housing, Affinity Sutton, East Thames Group, L&Q, Peabody, AmicusHorizon, Family Mosaic, Metropolitan, Southern Housing Group, Catalyst, Genesis Housing Association, Network Housing Group

mountain still to climb in the provision of new homes for the capital. Its latest report[13] points out:

- The average home in London now costs £421,000. Buying this home with a 75% mortgage requires a deposit of over £100,000 and a salary of £90,000, whereas the average salary is only £27,000.
- There are now 367,000 households on the waiting list for social housing in London, and population growth is set to exceed 800,000 by 2033 – the equivalent of one additional London borough every four years.
- The cost of private renting increased by 37% over the past five years and is forecast to rise by another 30% in London over the next five years.
- In 2011 London's housing supply increased by just 20,000 homes.

Table 1: Household projections and dwelling stock (thousands)

	Household projections			**Number of homes**			**Balance**		
	England	London	South East	England	London	South East	England	London	South East
2001	20,523	3,036	3,294	21,207	3,090	3,392	684	54	98
2002	20,691	3,074	3,314	21,337	3,106	3,417	646	32	103
2003	20,831	3,089	3,336	21,481	3,124	3,443	650	35	107
2004	20,969	3,108	3,353	21,636	3,146	3,471	667	38	118
2005	21,170	3,146	3,383	21,805	3,168	3,503	635	22	120
2006	21,344	3,180	3,408	21,992	3,193	3,536	648	13	128
2007	21,527	3,208	3,444	22,190	3,220	3,571	663	12	127
2008	21,731	3,244	3,480	22,398	3,248	3,606	667	4	126
2013	22,868	3,416	3,668						
2018	24,108	3,606	3,875						
2023	25,320	3,798	4,081						
2028	26,472	3,979	4,280						
2033	27,536	4,145	4,467						

Source: DCLG live tables 125 and 406

13 G15 *Beyond 2015 – Putting a Roof over London's Head* (November 2012)

There is some promising recent news in the private sector. According to the Council of Mortgage Lenders, mortgage lending appears to be on the rise, which bodes well for those associations that offer homes for sale. However, the market remains fragile and few expect a sudden return to the high point of the mid 2000s.

2.5 Welfare reforms

In late 2010 the government began outlining plans for a radical overhaul of almost all aspects of welfare support. Central to these reforms was the government's aim of reducing the nation's benefits bill, particularly in relation to housing benefit, simplifying the benefits system as a whole and "making work pay".

The Welfare Reform Act attempts to bring in a wide range of benefit changes, culminating in the phased introduction (2013-17) of universal credit, a single benefit to replace most of the current working-age benefits. By September 2013 the government aims to have introduced a limit on the amount that households and individuals can claim in social security – a benefit cap of £350 per week for a single person and £500 for a family. These amounts are intended to cover housing costs.

The impact assessment by the Department for Works & Pensions, published in January 2012, suggests that the cap will affect 67,000 households (around half of whom are in social housing), mainly large families living with high rents. Of these households, 36,180 are in Greater London. The assessment says that the average household will lose £83 per week. But 19,430 households will lose more than £100 per week and 11,390 will lose over £150 per week.[14]

Working-age tenants in receipt of housing benefit are to see their payments cut if they are deemed to be under-occupying their home. The bedroom tax amounts to a 14% reduction of housing benefit for those with one spare bedroom, rising to 25% for those with two. The rules state that one bedroom is allowed for each person or couple in a household. Children under the age of 15 are expected to share with one other child of the same gender, and those under the age of nine are expected to share with one other child regardless of gender. On average, housing association tenants affected will lose £16 per week, and for all tenants affected in London (of which there are expected to be some 80,000) the average loss is £21 per week.[15]

Another crucial element to the changes is that housing benefit will no longer be paid directly to landlords but instead go to the tenants. There is widespread concern among

14 DWP *Benefit Cap (Housing Benefit) Regulations 2012: Impact Assessment for the Benefit Cap* (July 2012)
15 DWP *Housing Benefit: Under Occupation of Social Housing – Impact Assessment* (June 2012)

associations at the likely scenario of mounting arrears and extra costs incurred by having to collect rent. A survey of 232 housing associations conducted by Ipsos Mori for the National Housing Federation found that registered providers expect arrears (on average) to rise by 51% as a result of welfare reforms. *Inside Housing* calculated that, extrapolated across the sector, this will mean an increase of £245 million in the arrears bill. This backs up the evidence of a pilot scheme run by L&Q (in which arrears more than doubled)[16] as well as the government's own trials.

Those surveyed expect that paying housing benefit direct to tenants rather than to landlords will have the biggest impact, with more than 80% of housing associations saying this will affect them significantly. Meanwhile, 22% said the changes will make it harder for them to meet their loan covenants, with 10% of those involved in the affordable homes programme saying that direct payment will make it harder for them to deliver their house-building commitments.

Other welfare savings, such as through the localisation of council tax benefit, below-inflation increases in most benefits and tax credits, and reductions in support for childcare, will place acute financial pressure on social tenants. Many in the sector fear that there may be more reforms to come, including the possibility of curbing housing benefit for those aged under 25.

Kate Davies, chief executive of Notting Hill Housing, commented that: "In terms of welfare reform we are encouraging tenants to supplement benefits by working part-time. I think inevitably we are going to see real poverty – people with suitcases standing outside their flat. It may be that we might have to set up a charitable fund to help people pay their rent."

2.6 Development grant post-2015

A cloud of uncertainty hangs over the sector regarding what might happen to development grant after 2015. As it is, many housing associations in London and the South East are in the midst of planning for a low- or no-grant future and see any grant at all as icing on the cake. Clearly, without subsidy, subsidised housing will be difficult to deliver.

A switch to the affordable rent model, whereby loans are raised by registered providers on the back of tenants paying up to 80% market rents, was announced in 2010. The new model, which in effect replaces capital grant subsidy with revenue subsidy, was

16 L&Q *Where's the Benefit?* (February 2004)

expected to help deliver 150,000 new affordable homes between 2011 and 2015. This was subsequently increased to 170,000, around half of which would be under affordable rent or affordable home ownership tenure.

Some £4.5 billion was made available to fund the new programme (£2 billion of this had already been allocated under Labour's spending review), compared with the previous allocation of £8.4 billion. As part of the housing stimulus package in 2012, an additional £300 million in capital funding was announced to support the delivery of up to 15,000 affordable homes.

London secured £1.8 billion to deliver 55,000 affordable homes between 2011 and 2015, including projects associated with the affordable housing programme and the mayor's new "housing covenant" to provide homes for working Londoners. While associations have welcomed the funding, the opinion among housing experts is that the main barriers to housing supply are the weakness of the economy and the lack of development and mortgage finance.

Housing associations are expected to benefit directly and indirectly from other schemes to boost housing supply, such as the Get Britain Building fund, the Build Now, Pay Later scheme, FirstBuy, the New Homes Bonus and the Growing Places fund, although few chief executives thought these schemes would compensate for the loss of capital grant. Indeed, some associations expressed concern that the support for affordable housing could be offset by the continued decline in planning gain (which, according to the DCLG, consistently provides for around half of all affordable homes in England). According to the National Housing Federation, the proposed relaxation of planning obligations under section 106 agreements, whereby developers would be allowed to remove housing requirements, could lead to a loss of around 35,000 affordable homes a year.[17] The Town & Country Planning Association has similarly warned that the relaxation could reduce the quantity of land available for affordable homes.[18]

The reformed community infrastructure levy, under which a proportion of levy revenue would now be paid directly to parish and town councils, is intended to incentivise house building. Housing associations are exempt from the changed levy, although it is still unclear whether affordable housing is capable of being funded from this source. The National Housing Federation is concerned that if community infrastructure levy were to be changed to allow it to include the cost of providing affordable housing, it

17 David Orr, quoted in: Wilson, W *Stimulating Housing Supply – Government Initiatives*, Commons Library standard note (February 2013)
18 Town & Country Planning Association *Growth and Infrastructure Bill*, briefing paper 36 (November 2012)

would in effect lead to commuting affordable housing requirements in some areas. "This would, almost inevitably, lead to much less affordable housing in good locations. Additional numbers could often be facilitated by building in less expensive areas, reducing the level of mix of tenure and income in the area where affordable housing is commuted. Commutation would also pose a serious threat to the supply of land for affordable housing."[19]

There is some expectation among associations that a future government might revert to some form of grant model, albeit on a much smaller scale. A further round of grant funding based on the affordable rent model may also be on the cards. However, some associations are saying they would not have the borrowing power to participate.

2.7 Borrow to build

In general, interviewees said they see a capacity for more associations to borrow to build, although there are mixed views on the scope for higher gearing. According to the Tenant Services Authority, the sector as whole has relatively low levels of gearing, with around £27 billion of unutilised security to cover future borrowing.[20]

Pat Richie, former head of the Homes & Communities Agency, suggests that "whilst for some organisations the affordable rent model pushes their gearing up quite high and they may not be able to repeat the contract they have right now, there is evidence that in some parts of the sector, there still remains a fair amount of capacity that could be used to a model similar to affordable rent that has government investment alongside borrowing of the association in using its assets. There is some capacity around that model rolling forward."[21]

The government is hoping that its latest plans to underwrite the debt of housing associations will boost borrowing.[22] However, associations do not appear to be sanguine about the scheme. According to David Montague, chief executive of L&Q, "It would only help to the extent that all housing associations take part. The terms have got to be so attractive that it creates a gold rush."[23] Some of the big investors in social housing bonds are reported to have warned the government that a guarantee scheme could in fact be counterproductive as it could drive down yields, thus making the bonds less attractive.

19 National Housing Federation *Community Infrastructure Levy Briefing Note* (2011)
20 Tenant Services Authority *2011 Global Accounts of Housing Providers* (March 2012)
21 Evidence to House of Commons Communities and Local Government Committee, 2012
22 See: DCLG *Next Steps for £10 billion Housing Guarantees* (February 2013); DCLG *Housing Guarantee Scheme Rules* (February 2013)
23 Wilson, W *Stimulating Housing Supply – Government Initiatives*, Commons Library standard note (February 2013)

2.8 The rent debate: rises for new homes?

Affordable rent in effect reduces grant to associations from an average of £60,000 per home to £20,000 per home.[24] For inner London boroughs such as Southwark, this equates to a cut from £120,000 per unit to £40,000. According to L&Q, if housing associations charged the full 80% market rent in London, this would mean a rent rise in a borough like Haringey from £126 a week for an average family home to £390 per week.

Most associations in London have set the affordable rent at between 60% and 65% of market rent, which they believe is actually affordable. The Homes & Communities Agency has also indicated that it would not expect rents to be over the local housing allowance cap for the area. In many parts of London, 80% of market rent far exceeds this limit. For the vast majority of low-income households with children, rents would be unaffordable because of the benefit cap.[25]

Another area fraught with uncertainty is the maximum level of rent that associations will be able to charge going forward. Allowing housing associations more flexibility over rent setting would provide a means of bumping up income to deliver more new homes, and the Chartered Institute of Housing is arguing the case for this. The downside is that it would increase the bill for housing benefit as well as rent payments for tenants.

Under the next spending review, the government may seek further savings on the housing benefit bill. It may, as has been floated, seek to replicate the changes made in other welfare benefits (tax credits, state benefits and public-sector pensions in 2011) by shifting rent increase inflation linkage from the Retail Price Index to the Consumer Price Index. Such a switch would impact on associations' business planning. There is concern in the sector that such a change in the rent settlement could adversely affect business planning and loan agreements.

Although changes to the rent formula may be off the agenda for now, the government is pressing ahead with its plans to charge higher-income tenants more rent (up to the full market rate). Several associations have questioned whether this "pay to stay"[26] scheme is economically viable or administratively workable.

24 National Audit Office *Financial Viability of the Social Housing Sector: Introducing the Affordable Homes Programme* (July 2012)
25 Affinity Sutton/Cambridge Centre for Planning & Housing Research *Bridging the Affordability Gap* (August 2011)
26 DCLG *High Income Social Tenants: Pay to Stay*, consultation paper (June 2012)

Chapter 3

Tomorrow's housing association: balancing the social and the commercial

Tomorrow's housing association: balancing the social and the commercial

The new financial and regulatory environment is asking some fundamental questions of housing associations. What are their social aims? What is commercially viable? What should the focus of their operations be? One of the tensions at the centre of the new reality is what balance should be struck between the social and the commercial. For some, the growing emphasis on the commercial aspect of the business is moving the sector away from its social roots. For others, however, it is liberating, allowing greater autonomy and more opportunity to cross-subsidise social housing. Where there is consensus among the interviewees is that the new opportunities available bring with them greater risks, demanding different skills and more effective boards.

3.1 Purpose and activities

Housing associations are currently being given more freedoms than they have had since the 1988 Housing Act, under which they took on their role as the government's de facto preferred deliverer of social housing. Alongside lighter-touch regulation, housing associations are also seeing a reduction in development grant, fewer stock transfers, and less opportunity for reaping the benefits of planning gain. This is forcing associations to be less reliant on the state. As described earlier, financial pressure is also being ramped up as the sector works through the consequences of major changes to (housing) welfare and reduced grant funding.

While some organisations are highly focused on how to grasp these challenges, often describing them as "liberating", others are sitting on the sidelines waiting to see what happens to the advance party. As the housing ombudsman, Mike Biles, observes: "Some housing associations are a bit at sea at the moment. They are used to guidance – now, effectively, they have been told they must find a solution themselves."

What is apparent from discussions with chief executives is that associations in this new operating environment need a clear definition of what their values are, who they should house, and the best ways to meet the needs of both residents and communities using the resources available. There is a great deal of analysis and soul searching going on across the sector in attempt to answer these questions. This is coupled with an intense scrutiny of structures and operations in order to improve performance, cut costs and improve efficiency.

Interviewees felt quite strongly that housing associations should stop dabbling in everything and focus on a few core essentials. But at the same time there is a growing interest in "doing a bit of private rent" or scaling up new development in the private rented sector.

Matt Leach, chief executive of the Housing Associations' Charitable Trust and former Housing Corporation official, said: "For the first time in decades housing associations are being entrusted with a degree of self-definition. In the past, I would say so much of what housing associations have done has been driven by regulation."

Leach identifies two trains of thought for the way forward. The first holds that it is better for an organisation to focus on the supply side and be a super-efficient developer. The second aims to boost efficiency and value for money by offering wider community services that will help cover the cost of overheads – for instance, Aster Group, which is just about to set up an academy. But he does not see the two approaches as mutually exclusive: "I don't think it's about size – it's about identifying what you're there for."

The commonly held view is that associations need to be clear about social objectives to help drive efficiency. According to David Montague, achieving efficiency means focusing on what you're good at and concentrating resources in those areas. He explains why L&Q no longer, for example, provides temporary accommodation, care and support: "Other people do those things far better than we do. And as a result of boosting the bottom line we support a number of supported housing groups. For example, we pay £10 million to Broadway – a charity for the homeless."

L&Q has a £2 billion investment programme with a 10,000-unit development pipeline. It stresses that it is extremely focused in terms of its property portfolio, which is concentrated in London and the South. This, according to Montague, "allows us to know our residents, and manage our assets efficiently. We also have our own construction company, so we also keep the construction profits when we build homes. The key thing with making efficiencies is having the will to do it and then giving people the tools. Over the next five years I think we will see the sector continue to drive efficiencies. Associations will take measured risks, and I think we'll see a different culture and different leaderships. It will become more commercial, but with the difference to a private-sector company that the profits we make go back into society."

However, with efficiency and value for money the all-important goals, there is a concern among some observers that community activities and the sector's historically social ethos are increasingly taking a back seat.

3.2. Culture versus commercialism

"As with all successful organisations, housing associations need to change to suit the times – but they mustn't forget their values either." Tom Murtha, former chief executive of Midland Heart and chair of the Housing Associations' Charitable Trust, expressed the concern shared by many about the identity of the housing association of the future. They are asking whether associations that take on a more commercial mantle are at risk of leaving behind their traditional socially caring ethos, losing their engagement with tenants and leaving behind any campaigning zeal. Before long, their fear is that housing associations will be indistinguishable from private-sector companies.

This is an understandable concern, and one that has been troubling association boards for some time. However, most chief executives believe the two approaches can work well together. Murtha cautioned: "It doesn't mean you can't be efficient or make money, but you have to bring something different – you need social values – and you have to balance the two. There are three key ways you can move forward. One is by being extremely efficient and extremely financially secure, so over a period of time you become private businesses in all but name. But then you're not really any different to private landlords, paying lip service to community involvement and becoming indistinguishable from private businesses.

"The second route is through diversification. As the NHS is privatised, I can see more and more housing organisations over the next 10 years providing a whole range of care services; it is not just about growth and ambition, it is about entering the space that others vacate. And moving into these fields puts housing associations increasingly in competition with private-sector providers. I don't think that's a bad thing, but they can't compete at all costs – they have to ask themselves what's the level, say of cost, which they wouldn't go below.

"Then you have a third road, which is all about providing a good housing service and continuing to develop the community model, such as the path taken by Plus Dane. I don't see a problem with any of the three ways – but it really depends who is in charge. I think there is an element of who is leading the organisation that will determine whether it continues to fulfil its social values."

The underlying argument of the larger and more commercially minded associations is that the more surplus you can make, the more you can reinvest into building additional homes. David Cowans noted dryly, "You can't be a philanthropist without any cash."

Lord Best, chairman of the Hanover Group, commented: "The biggest housing association landlords are big businesses, albeit social ones, but are comparable in size to those in the FTSE 100. If you are that kind of size and have that sort of responsibility you have to adopt practices of the private sector. In doing so, you may lose some of the passion and commitment that are the hallmarks of smaller organisations. But what you gain is that the sector is now supporting far more people in their housing needs. And to me, the good work outweighs any loss."

Perhaps one of the big tests might come with the bedroom tax, which raises the spectre of people losing their homes because they cannot afford to pay for their spare bedroom. Paul Tennant, chief executive of Orbit Group, remarked that housing associations could end up subsidising the government, as it would be difficult to evict a family for the sake of £11 a week. But others are likely to take a tougher stance from the start, for fear that if they don't it will hurt their balance sheet.[27]

3.3 Diversification and social value

Given the contraction in state support, some housing associations are seeking to diversify their activities. But others fear that as associations seek greater efficiencies, their investment and involvement in community activities will be reduced.

To resolve this tension, there is an increasing interest in measuring and rewarding social value. Indeed, under the Public Services (Social Value) Act 2012 housing associations must define the social and economic value and impact of the services they offer, when tendering for a contract from a local authority or another relevant body. Some in the social enterprise sector suggest that the act will promote new partnerships between associations and social enterprises.

Ashram Housing Association has been reported as saying that every £1 invested in its employment and skills service is worth £5.67 in terms of helping people into work, increasing tenant well-being and reducing benefit dependency and rent arrears. The association says that measuring social value offers "huge opportunities" to extend the work it does.[28]

27 Comments made at the launch of the LSE/Orbit report, B*igger than Business: Housing Associations and Community Investment in an Age of Austerity* (November 2012)
28 Kate Murray, "£5.67: The Value of £1 Spent on Confidence and Skills for Tenants" in *The Guardian*, 7 November 2012

Measuring return on investment in affordable housing

Just as the measurement of social value has become a quest to help housing associations quantify the benefit of non-core housing activities, there are also developments afoot that will allow them to demonstrate how well their property is being managed. Straightforward commercial measurements do not take into consideration the fact that they are operating as a social business that brings with it a social dividend. To solve this problem a group of seven associations is exploring the idea of setting up a new kind of performance index for social housing based on the International Financial Reporting Standards and Global Investment Property Standards. These are used by an organisation called Investment Property Databank, which provides an index for commercial property. Adopting the IPD for English social housing could help associations when making investment decisions and provide a good barometer to compare the return on investment of each other's properties.

A number of associations are looking at opportunities in running government work programmes, and measuring impact in this way might help them win the work. As one interviewee says: "If a housing association is working in a very deprived area, knows all the tenants and is getting people into work or keeping them out of prison, you may not be able to measure what that's worth financially, but that sounds like a pretty good outcome to me."

The Housing Associations' Charitable Trust has been working on a number of initiatives around social value, including a project with the London School of Economics to measure the value of all the different aspects of providing a decent home. It says that analysing the impact of individual community initiatives is less important than looking at the social impact of a business as a whole and how that then influences the investment choices made. The trust also believes it is important that associations do not simply duplicate the work of other groups – such as doing their own work programmes without attempting to find out how this could dovetail with existing schemes.

Interviewees noted that there will clearly be a far more business-like emphasis on investing in community programmes that deliver demonstrable benefit, rather than participating in them because it seems "the right thing to do".

One chief executive concluded: "As a sector we spend a lot of money on health programmes. Is it saving the NHS money? And if yes, is it our role to do that? You can build a lot of houses if we used that money differently. We shouldn't be frightened to ask ourselves these questions."

3.4 Commercially minded, commercially skilled

As housing associations take on bigger risks, gear themselves up and start branching out into new areas, the biggest concern among those working with them is whether they have the requisite skills at board and management level to thrive in this new world. The recent problems at Cosmopolitan Housing Group, which got into financial difficulty over investments in student housing, bring to the fore the level of complexity that boards need to master.[29]

Although many chief executives might not like to admit it, the sector arguably still lacks the skills set to compete effectively with the major players in the private rented sector. Growing that skills set will be a major challenge. It may become emblematic of the tensions that emerge when associations seek to balance their social heart with their commercial mind.

Some chief executives mentioned the problems that happened in the Netherlands, when the social housing group Vestia lost billions after maladroit dealing in derivatives and interest rate swaps. The 90,000-home landlord had to raise rents and sell stock to repay €1.3 billion to the banks, and the rest of the sector had to raise €700 million to bail out the organisation. Other Dutch associations have since found themselves in similar financial trouble.

According to the Dutch National Tenants Association, "What really hurts is that the system was designed to prevent small and not very wealthy housing associations from folding. Now it is the big one... and tenants have to pay for it... Accountants saw their accounts, the regulator saw the accounts, the guarantee fund has seen the accounts, as had the board of directors and still it went wrong. So tell me why it could not happen in England?"[30]

The Homes & Communities Agency is aware of what happened in the Netherlands and is keen to ensure that there is effective self-regulation here. Julian Ashby, chair of the agency's regulation committee, told the National Housing Federation conference in 2012 that the sector is in a risky operating environment, and said association boards will "require stronger governance and stronger risk management. You will need an iron grip on treasury management and particularly on covenant compliance."[31]

The fear is that if a few housing associations fail because of their private activities,

29 "The Rescue Mission" in *Inside Housing*, 26 October 2012
30 "Never Too Big to Fail" in *Inside Housing*, 21 September 2012
31 Carl Brown, "Landlord Boards Must 'Improve Risk Management'" in *Inside Housing*, 18 December 2012

then the whole sector could be put at risk through poor credit ratings. Finance experts have also pointed out that if the commercial side of an association's business gets into difficulties, then in effect the social side of the business would need to bail it out.

As the sector becomes more complicated, the role of directors and board members becomes more difficult. To manage the complex relationship between private and public activities, many housing associations are drafting in people with a wider skills set.

The newly appointed chief executive of Moat, for example, Elizabeth Austerberry, was most recently director at global accountancy firm Ernst & Young. Sovereign's chief operating officer, Jonathan Cowie, is from the telecoms sector. "Many of our managers are coming from the private sector," says Ann Santry, chief executive of Sovereign. Indeed, the new chief executive of the Homes & Communities Agency, Andy Rose, has a strong commercial and financial background.

If more associations do not follow suit quickly, one senior housing expert is fearful of further financial difficulties. "Unless there is major change, I think we'll see major casualties. Housing associations are taking on huge loans... and the board and the executives must understand these risks. I think chief executives need to have fixed-term tenures to encourage new ideas. They say that they are commercial – but I don't think they are. I think there is a real dearth of talent in the commercial areas. You hear housing associations aspiring to be like other housing associations – but why not raise their game to being like a John Lewis or Virgin?"

Although few board members want their associations to become the next Virgin, most have high aspirations. And, despite differences in approach, chief executives want to run organisations that provide high quality of service and good value to their customers; that treat their staff well and allow them to share in the rewards; that maintain high ethical trading values; and that are creative and innovative in keeping ahead of the competition.

Neil Hadden added that "a lot of commentators fail to appreciate the legal status of associations: we are not part of the state and cannot be designed by the state. We are independent organisations able to determine our own sphere of activity, and increasingly we have greater scope to determine our own future."

Chapter 4

Mergers and value for money

Mergers and value for money

Housing associations have not been hit as hard as other service providers. However, given the reductions in capital subsidy, most associations feel they have little option but to be more commercially minded. Part of that new mindset entails greater attention to securing value for money. Several associations cited the benefits of using benchmarking and changing organisational structures to deliver value for money. Others mentioned the possibility of mergers as a means of driving down costs and raising borrowing capacity. There was also a general acceptance of the need to be more proactive in managing assets, including rationalising stock to maximise returns on investment.

4.1 Getting more for less

Housing associations arguably might not be facing the severity of cuts experienced by many public-sector organisations, but if they want to provide more homes – which means generating healthy surpluses – then the pressure is on to do more for less.

The new requirement from the Homes & Communities Agency's regulation committee to demonstrate value for money will be another key driver. It is, however, a little vague on how tough the agency will be in judging value-for-money standards, and what actions might be taken against those it decrees are not demonstrating value for money.

Housing associations may also face increasing competition from for-profit management firms. The Greater London Authority, for example, encouraged bids from all types of housing provider in its recent competition to encourage innovative solutions for low-cost housing for Londoners on modest incomes. How far the boundaries between social and private housing providers will blur is hard to tell, although many interviewees noted that the emphasis at the DCLG and the Homes & Communities Agency is more on solutions, rather than on type of provider.

Among interviewees who are not themselves practitioners within housing associations, there is a widespread perception that associations are not inherently very efficient. Criticism was levelled not so much at the way they are run but in the make-up of the sector – too many associations with their associated overheads and stock dispersed over too many areas. Others criticised their development skills and modus operandi. They wondered, in the absence of any real market forces, what would drive out waste in the sector. One interviewee asked: "Why do associations even have development arms? Why not commission a house builder? It doesn't make sense [for them] to be outbidding Barratt Homes for land."

Housing associations appear to be taking the challenge seriously. A survey last year of 50 organisations in the sector by accountant Baker Tilley revealed that 78% were planning to introduce efficiency and saving initiatives to reduce back office costs. It also showed that almost seven in 10 organisations engaged in benchmarking programmes to measure cost and quality against their peers. That's more than double the previous year, when 32% said they were benchmarking their back-office performance.[32] Similarly, evidence that housing associations are now looking harder at their costs can be seen from the Tenant Services Authority's 2010 global accounts for housing providers, which found that "for the first time in many years, operating costs per unit decreased in real terms, particularly in management and major repairs" and that operating margins increased during the financial year from 14% to 18%.[33]

However, as a KPMG survey looking at the future activity of housing associations in 2012 showed, on-going efficiencies will need to be driven by major organisational change as the quick wins will have already gone.

June Barnes, chief executive of East Thames, said: "It is a gloomy time in the housing sector, and it is incumbent on us to find ways of supporting our residents through the changes and to manage our bad debts. We have instituted a major change programme to improve customer services and significantly reduce costs. This has involved a root-and-branch review of everything we do, how we run the business, what we spend time on, and questions such as whether we are really getting things right first time. We believe this will help us, our residents and our partners weather the next few years."

In other examples of organisational change, a number of housing associations, including Midland Heart, Genesis and Sovereign, have already collapsed their group structures into flatter organisations. And some see stock rationalisation to concentrate efforts geographically picking up pace.

4.2 Mergers

One area consistently talked about by chief executives is mergers. There is a widespread expectation that there will be more mergers – though arguably there is not the amount of pressure to merge as there would be in a market-led industry. However, as David Cowans observes, "there's an inescapable logic to mergers".

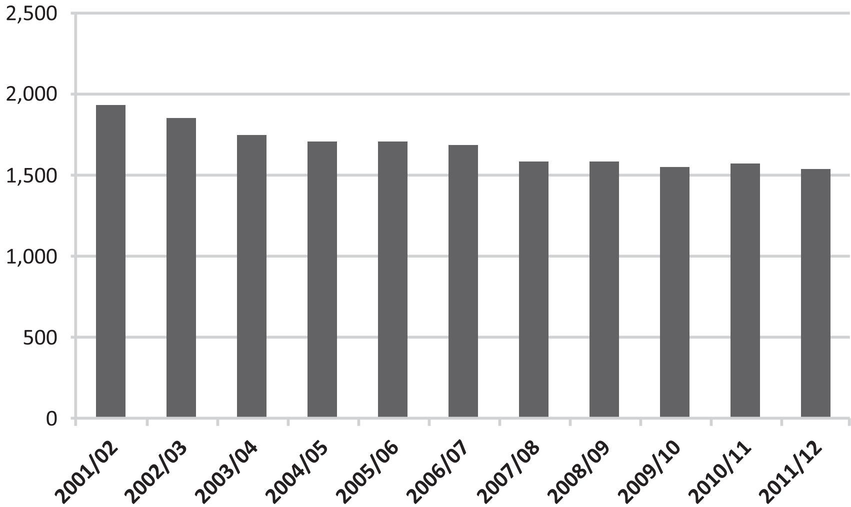
The number of housing associations has fallen over the past decade, mostly through the loss of small associations. Nationally, the largest 20% of associations now own

32 Baker Tilley *Signs of Progress: 2012 Back Office Benchmarking Report* (2012)
33 Tenant Services Authority *2010 Global Accounts of Housing Providers* (March 2011)

around 90% of the total stock. In London the fifteen associations of the G15 house one in 10 Londoners and manage over 400,000 homes. On current trends, the number of associations is expected to carry on declining. At the same time the larger associations are likely to become larger, and some interviewees believe the first 100,000-strong unit association may be just around the corner – Office of Fair Trading permitting.

While growth in the number of units owned by large housing associations is largely attributable to stock transfer from local authorities or new build, a not insignificant amount has come from transfers within the sector – from one association to another. For example, in 2010/11 – when the number of associations was fairly static – 29% (or 17,386 units) of transfers to large associations came from within the sector.

Figure 3: Number of housing associations in England



Sources:
Data for 2002/03 to 20008/09: Cambridge Centre for Housing & Planning Research *Trends in Housing Association Stock in 2009* (2010), taking 2002/03 from table 5 of 2003 Profile of the HA Sector Tables; 2003/04-2005/06 from table 2 of 2004 to 2006 Profile of the HA Sector Tables; 2006/07-2008/09 from table 10 of 2007 to 2009 Profile of the HA Sector Tables.
Data for 2008/09-2010/2011: table 10 of HA Sector Tables from RSR data
Data for 2011/12: HCA *Statistical Return 2011-12 for England* (2012)

Notes: Data is based on returns to RSR survey. For 2011/12, given the low levels of responses (81%, compared with 99% in the previous year), it is based on the overall number of registered providers.

Affinity Sutton chief executive Keith Exford believes that mergers will increasingly be driven by the need to raise borrowing capacity rather than create efficiencies, as so many inefficient practices have been squeezed out already. There is also debate about whether the cost of refinancing is holding back mergers.[34]

One newcomer to the sector remarked: "I've never seen so much waste as there is in housing associations. And there are far too many of them. You'll see three councils coming together to share services, yet in the same area there might be 20 housing associations working independently of each other. It doesn't make sense."

Elliot Lipton, founder of house builder First Base, firmly believes that mergers could leverage more cash for development. He estimates that there could be several billions in efficiency savings to be had by merging associations, managing more efficiently and rationalising stock. "You look in an area and expect to find one association and discover there are five. The Homes & Communities Agency statistics show huge variation in the cost of management, with the worst performers costing 10 times as much as the best. They should make better use of assets. When it comes to development, why don't all associations follow the lead of the best, and develop with maintenance in mind?

"There is a tendency in the sector to do things because their competitors do, without really knowledge of how to minimise liabilities. Generally, I think the government needs to look at the underlying rationale for the way they operate and see how they can drive more efficiency and value in the sector whilst maintaining a high-quality service and appropriate safeguards."

Some in the sector are worried that the government could do something rash, as it eyes up surpluses, including some sort of asset raid on the sector. Neil Hadden remarked, "I think we will see a great deal of political pressure to make sure we are getting the most out of our surpluses." However, it was also said that mergers are not always the answer, and that the merger debate is all too often complicated by personality issues and self-interest.

4.3 Mergers – not always the answer

While many advocate mergers to increase efficiency, there are no fewer who point to a lack of evidence supporting such an approach. A recent study by the Homes &

34 That this is indeed the case was suggested by a recent paper from Professor David Mullins of the Third Sector Research Centre, University of Birmingham: Mullins, D *Third Sector Partnerships for Service Delivery, English Housing Mergers and Groups Case Study* (2012)

Communities Agency was inconclusive.[35] So too was a report from the Chartered Institute of Housing.[36] The HCA report said that, on average, providers recorded net operating costs per social housing unit at £3,440 during 2010/11. The report found that there was considerable variance between providers around this mean figure: for two-thirds of providers, operating costs per unit ranged between £1,200 and £6,800.

The report concluded that half the differences could be accounted for by factors such as how much supported housing the association offered, regional wage impacts (in London these are 36% higher than for those operating in the North East), stock transfers, neighbourhood deprivation, and Decent Homes activity. Evidence on cost variations was weaker relating to group structures, size of organisations, new development and the degree to which stock was rural in location or geographically dispersed.

The report concluded: "About 50% of variation in unit costs between providers each year can be explained, but understanding costs and outcomes at provider level and what accounts for differences with peers is a task for individual providers and their boards. Providers need to be able to demonstrate how higher operating costs are linked to underlying cost drivers and delivery against their objectives."

Paul Phillips, group finance director of Notting Hill Housing, who was involved in the study, says: "We did some work on the G15 and found that the larger G15 registered providers seemed to have a lower unit cost than the smaller ones." However, Phillips says that because the G15 providers tend to have a different stock profile from the smaller ones, it is difficult to compare the two and thus to understand the differences fully.

4.4 Asset management comes of age

Chief executives admit that asset management has not always been a high priority, although most believe this is changing as a result of commercial pressures and new freedoms such as greater flexibility over stock disposal. According to the National Housing Federation, associations need to a take a more proactive approach in developing long-term asset management strategies. Its guidance to associations highlights the key drivers, such as energy efficiency and sustainability of stock and contract management.

Kate Davies of Notting Hill Housing said: "We are still a social enterprise – we feel under no pressure to change our culture. We want to stay as a charity, and there is

35 Homes & Communities Agency *Understanding Unit Costs of Housing Providers – Regression Analysis Summary Report* (August 2012)
36 Chartered Institute of Housing *Does Size Matter -- or Does Culture Drive Value for Money?* (January 2012)

no reason not to. We have thought carefully about the future of some of our valuable stock. The homes which are too small, too expensive to repair or just pretty hard to let may be considered for sale or conversion to market rent when void. This would enable us, through active asset management, to recycle the receipts to procure larger family homes which are in great demand in London."

Some interviewees also mentioned the likelihood of associations selling off more expensive stock and improving their stock turnover under the Homes & Communities Agency's new disposals regime.[37] Genesis was the first association to receive consent for its disposals strategy, which will involve the sale of 350 homes, with the money being recycled back into new affordable housing – although not at the same rent levels. According to Neil Hadden, chief executive of Genesis, "the introduction of fixed-term tenancies allows housing to be let on a five-year basis. That gives us more flexibility and allows us to start to do things with stock we couldn't do in the past, like sell it or turn it into market rent."

37 Homes & Communities Agency *Disposing of Land, regulations* (May 2012)

Chapter 5

A changing social business?

A changing social business?

While housing associations are seeking to drive down costs and improve value for money, the new financial reality of low levels of grant demands that they look at different funding models and new revenue streams. The majority of associations believe that without grant levels returning to their previous heights the only way to deliver social housing is by cross-subsidy: building homes for private sale or private rent, and converting properties from social to affordable rents.

The push towards the greater use of market rents will alter the mix of association tenants. However, as the next table illustrates, non-social rented homes still form a relatively small percentage of the total and it would take consistent change over a long time to radically alter the mix of stock.

Market conditions and the recent shifts in housing policy nevertheless open up new freedoms in terms of funding. Institutional investors show greater interest in commercially driven housing with a good return rather than in social housing, and private renting offers such an opportunity. However, associations are only tentatively entering this market.

Despite the impact of fiscal austerity, associations are increasingly looking to deliver added value through community services, which can provide an additional income stream.

5.1 Is the stock changing?

As table 2 shows, the vast majority of stock remains general-needs social housing. Over the period covered, 2005 to 2012 – which included a change of government and an economic crash – general-needs housing showed the biggest rise (in the earlier years largely through large-scale voluntary transfer). While other forms of housing have fluctuated, there has been a real increase in non-social leased housing, such as shared-ownership homes. However, non-social leased housing still represents just 1% of housing association stock. This illustrates the time it could take for a major shift in tenure and forms of housing provided by the sector.

The table illustrates the feed-in time that policy changes and incentives take to produce results, as there is no discernible increase in the proportion of non-social rented properties owned by associations despite the interest of interviewees in this area.

Table 2: Housing association owned stock

	General needs	Supported housing	Housing for older people	Social leased	Non-social rented	Non-social leased	Total
2005	1,523,318	101,053	257,592	94,705	34,631	2,086	2,013,385
2006	1,547,390	99,355	293,615	100,402	36,573	2,180	2,079,515
2007	1,620,476	98,773	306,303	112,024	38,562	2,085	2,178,223
2008	1,713,124	98,994	316,557	126,108	40,767	818	2,296,368
2009	1,776,095	99,368	320,662	135,218	45,208	3,177	2,379,728
2010	1,825,510	101,742	316,188	139,733	50,318	3,514	2,437,005
2011	1,896,253	103,207	320,846	146,618	56,683	3,032	2,526,639
2012	1,949,565	109,021	299,941	150,271	47,881	29,436	2,586,115

Source: HCA *Statistical Release Statistical Data Return 2011-12* (2012)

5.2 From administrative to entrepreneurial developer

Most associations are preparing for a life without grant. As one board member put it, "even with grant at the 50%-60% levels, margins on development were always tight". The view from most of the G15 is that the only way to offer a submarket rent now is to cross-subsidise from private sale or private rent. And if associations do subsidise new submarket rented properties in the future, by and large this will be at much higher levels of rent than target rents. Traditional low-cost social housing appears difficult to develop without a return to grant.

The sector seems to be moving from being an administrative developer to being an entrepreneurial developer. Andy von Bradsky, chairman of PRP Architects, captures the new thinking: "Associations will be more like house builders with a social housing arm than social landlords with a house building arm."

The Greater London Authority is pushing the process along with a new £100 million fund for the development of intermediate homes for people on modest incomes. The pot of money, of which the first £40 million has now been allocated, was open for bidding from both the for-profit and not-for-profit sectors. Associations said they expect to see this approach continue for the foreseeable future.

When the fund was announced in September 2012, the Greater London Authority said: "The mayor is seeking proposals from any providers that can develop intermediate housing in London. In particular, organisations not currently working with the GLA or who have not received GLA funding in the past are encouraged to bid. Organisations could include London boroughs, housing associations, developers and house builders, for-profit and not-for-profit bodies such as charities."

According to David Lunts, executive director of housing and land at the Greater London Authority, the message from the mayor's housing team is that even if there is grant in the future, "we'll be looking for a more ambitious and imaginative approach from those bidding for it, and we expect to see housing associations operating a mixed-economy approach".

Although a number of housing associations are planning for a future without subsidy, it's not a done deal yet. Lord Richard Best is convinced there will be housing grant made available, probably at the same level as it is now. He said: "I certainly detect the government is serious about getting more homes built and they are trying to get rid of barriers that are stopping that – so I think there is real interest from government towards housing associations."

But Lord Best concedes that welfare reforms and the potential for increased arrears are likely to affect housing associations' ability to borrow: "I would think that if arrears only double, then housing associations have got away lightly. But there appears to be a vague feeling amongst ministers that housing associations have plenty of cash so they can take big hits like welfare reform."

The Greater London Authority has not given up hope of grant and is lobbying for continuation of subsidy to build new homes. London Councils (which represents all boroughs in the capital) is also working on the assumption that grant level will be maintained at the level it is now after the present spending review. But that still leaves a massive gulf between supply and demand, and as one council chief put it, "We need to think outside traditional models."

5.3 A different mix of tenants and tenures

What seems unarguable is that unless subsidy returns, the building of new conventional social housing with rent at current levels (roughly around 35%-40% of market rents in London) will become rare.

For many, the only way to provide low-cost housing for households on low incomes is to cross-subsidise profits made from housing at or closer to market rates. Keith Exford said: "We will continue to use our resources to develop and provide affordable homes.

But one of the things we are discussing with our board at the moment is for which clients we do this, and where, and how much, and at which price points. There is no silver bullet for affordability; development is unattractive without grant. We're asking at the moment: what sort of risk would we be comfortable with and what sort of rent levels?"

Notting Hill Housing Group is developing homes across the range of tenures, including 700 properties for private rent that are handled by a separate management team and separate legal entity to make profits which can be ploughed back into the social housing business. "We are looking to expand private rent, and eventually, we'd like to follow the German model where people are offered incentives to stay long term. We've found that we make a better return than expected from private rent because management costs are less than we anticipated, as tenants are actually less demanding in terms of repairs."

Ann Santry, Sovereign chief executive, concurs: "We're having a debate internally: who do we house? And the answer is most certainly a wider mix of people, with more market focus than in the past." Local authorities that have council housing stock are having similar discussions about their long-term strategies. For many London boroughs, the provision of new social low-cost homes (rather than affordable homes, which have a grant entitlement) without capital grant is financially very difficult.

Family Mosaic is heavily subsidising its affordable rent programme and will cut the number of new homes it builds in future to allow it to continue to do so. Similarly, Islington council is using £700,000 from its New Homes Bonus to subsidise rents in new family-sized homes being built in the borough by Islington & Shoreditch Housing Association.

Associations are also converting social rents to affordable rents as units become void, although the extra income generated is limited because the tenant turnover is small. In London, for example, some say they will continue to build at submarket rents, but these are likely to be around 60%-65% of market rent – the pricing level on which most associations appear to have settled for the current affordable rent programme.

At present, however, affordable rent stock makes up a relatively small proportion of overall numbers – just 7,889 units in March 2012. This figure could rise once the policy takes full effect, especially for new build. However, given that existing tenancies comprise the vast majority, it may (without further policy changes) take some time for churn and new build to significantly change the make-up of the whole sector.

The general view among associations is that the focus for new homes will be largely on future tenants who are in work and who are not (or at least are less) reliant on housing benefit. This has provoked some councils to claim that they are left carrying all the burden of housing the most vulnerable. All the policy drivers are pulling associations away from housing the very poorest, which is placing enormous pressure on councils to allocate more people in the private rented sector.

Changing market conditions and welfare reforms (notably the benefits cap) will undermine efforts by associations to provide more family homes. Despite the London mayor's plea to the G15 for an increase in family-sized homes, four-bedroom development has come to a virtual halt in London and the South East.

However, some associations are resisting a return to building one-bedroom units. As Angelo Sommariva, policy director at Moat, explains: "One-bedroom properties are inefficient: they don't allow families to grow and they are inflexible at the older age end. Despite the higher cost of build, two-bedroom homes typically represent greater value for money." Others, like Peabody, are considering renting family-sized homes at well below market rents.

Demand for shared ownership is high, but mortgages remain difficult to obtain and fewer potential buyers can afford the higher deposits. Furthermore, latest evidence[38] shows that very few households in shared ownership are able or willing to staircase up to full owner-occupation. This could put some associations' assets at risk or at least deter the development of shared-ownership schemes. Associations have discussed the option of converting shared-ownership programmes to shared-equity, although this would demand a much higher grant rate.

5.4 Opportunities and risks with private finance?

The financial crisis and the large reduction in grant has made the sector less reliant on bank finance and more reliant on short-term capital from bonds – usually between £100 million and £300 million per housing association. In 2012 housing associations raised around £4 billion from the capital markets, equivalent to half the total bond issuance of associations over the past 25 years. According to the Council of Mortgage Lenders, around 37% of the capital needs of associations are now raised through bond finance, compared with as little as 5% in the past.[39]

38 University of Cambridge Understanding the Second-hand Market for Shared Ownership Properties (Thames Valley Housing, June 2011)
39 Council for Mortgage Lenders evidence to House of Commons DCLG select committee inquiry into financing of new housing supply, 2012

This shift away from traditional debt finance has affected all associations. Even small organisations have been able to join the party using aggregating vehicles such as The Housing Finance Corporation. Some chief executives are nevertheless more cautious and point out that bond issues can absorb a lot of time and effort as well as demanding scale which is not always possible. The bond markets meanwhile have raised some concerns recently about the robustness of social housing regulation under the auspices of the Homes & Communities Agency. In particular, there have been questions raised over the willingness of the regulator to bail out a failing association.

Other forms of alternative credit have also emerged, including retail bonds. Places for People, for example, successfully raised £140 million in a retail bond in May 2012 and has just issued a second bond.

Some in the sector suggest that UK real estate investment trusts (REITs) may be a suitable vehicle for funding and spreading risk, especially for the larger associations. A survey of 60 housing association senior executives by BDO (the accountants and business advisers) in 2011 showed that over half were interested in converting to a UK REIT.[40] Several models have since been proposed, but there has yet to be a breakthrough. Interviewees suggest that investors remain unconvinced about both the returns and government backing. According to the *Investors Chronicle*, associations could appeal to private investors, combining utility-like cash flows and inflation protection with a strong social purpose, "but any social housing REIT that does succeed in listing this year will face a barrage of questions about the long-term viability of the grant dependent business model. It may pay to stay away at least until the dust settle in the new benefits system."[41]

Interviewees also spoke of attracting more investment from institutional investors (notably pension funds and insurance companies) for private rented housing. The appetite among institutional investors is said to have risen as residential property yields in high-demand areas have become more aligned to other commercial investments. According to the Montague report, there is a strong case for investment in the private rented sector and "the evidence we received challenges the perception that yields in the sector would always be insufficient to attract investment, particularly when compared to commercial property".[42]

Although the large pension funds have traditionally shown little interest in the sector,

40 BDO survey of registered providers of social housing (2011)
41 "Social Housing REITS" in *Investors Chronicle*, 18 January 2013
42 Montague, op cit

the mood seems to be changing – albeit slowly. Genesis, for example, recently signed a ground-breaking £125 million sale-and-leaseback deal with M&G Investments, creating one the UK's largest institutionally backed residential investment portfolios (see box below).

Genesis sale-and-leaseback deal for private rent

In 2013 Genesis finalised a ground-breaking £125 million deal with M&G Investments, which last year invested over £1 billion in housing association debt. The initiative is the largest of its kind and the first in London. Under the terms of the deal, M&G's Secured Property Income Fund is buying 401 properties for private rent inside the Genesis built-and-owned Halo Tower in Stratford. M&G is then leasing back the properties to Genesis to manage for the duration of the 35-year leaseback period, throughout which the housing association will make inflation-linked payments to M&G. The properties will remain with M&G, which frees up funds for Genesis to reinvest in new homes.

Some chief executives expressed a particular interest in local authority pension fund investment following recent announcements by the Greater Manchester Pensions Fund and the Islington Council Pension Fund about their intention to invest in residential property. However, recent studies[43] suggest that although there are new opportunities for local authority pension fund investment in affordable housing, the prospects have been exaggerated. Few funds are prepared to accept lower returns in exchange for achieving social benefit. A Smith Institute survey of local authority pension fund managers and trustees in 2012 concluded that "most funds would be interested in developing impact investments in the future, provided that: rates of return and the right risk profile could be achieved; there were no conflicts of interest; the investment schedule was clear; there was a track record of delivery; and investors had a clear exit strategy".[44]

Investors and associations are concerned that the transition to the unified benefit universal credit could destabilise the new funding environment if a resulting increase in rent arrears were to drive up borrowing costs. Pilot schemes on direct-to-tenant payments showing that rent arrears have risen as a result[45] are adding to the anxiety. As the Homes & Communities Agency sector risk profile states, "it is the changes being introduced as part of the welfare reform agenda that have generated the most interest in the sector and amongst key stakeholders such as banks and institutional investors".[46]

43 See: *Local Authority Pension Funds: Investing for Growth* (Smith Institute, September 2012)
44 Ibid
45 The DWP's early findings of the six pilot areas shows rent collection rates dropped to 92% – "Early Findings of Direct Payment Demonstration Projects: Payment Figures Published", DWP press release, 17 December 2012
46 Homes & Communities Agency *Sector Risk Profile* (June 2012)

In late 2012 Moody's, for example, downgraded the credit rating of almost all housing associations from AAA to AA1. Its assessment was that universal credit adds risk, although it added that this was manageable for rated housing associations. Moody's also noted that greater reliance on non-core commercial activities (such as sales) and exposure to market volatility from floating rate debt and hedging positions would exert pressure on ratings: "This source of income is less stable than traditional social-housing letting and fluctuates with market conditions, adding uncertainty to projections. An inability to manage sales turnover and related cash flow, leading to higher debt levels, would be credit negative."[47]

Interviewees commented that investors may view the sector as more risky once the extent of the welfare reforms is fully known, and bond pricing could become more diverse between associations. However, it was also mentioned that housing associations still boast strong credit ratings and have few options other than to seek bond finance.

Some chief executives have called for the government to write off the sector's £40 billion of historic grant, which is a payable charge on their balance sheets. One proposal is to turn the debt into equity to free up investment for new homes. While ministers have said they would consider the request, most associations believe that the odds are stacked against it happening – not least because the Treasury (and parliament, or at the least the House of Commons DCLG select committee) remain unconvinced. It was said that lenders are reassured by the presence of grant on associations' balance sheets and writing it off could reduce their ability to borrow.

5.5 Private rent – who is doing it and will it stack up?

As far as the future shape of organisations in the housing association sector goes, the eyes of associations are fixed firmly on the private rented sector. So, too, are those of the government. It is banking on housing associations to increase supply to meet the desperate need for high-quality accommodation for the increasing number unable to get on the housing ladder or into social housing tenancy.

According to the Montague report, "among the larger associations, there is starting to be considerable interest in market rent developments as a natural complement to their existing activities in affordable housing. The associations have the potential to become key players in the development of bespoke private rented schemes, as the balance sheets of at least the strongest… will support standalone capital raising to finance developments. In addition, their existing affordable housing portfolios give them both asset management expertise and a strong platform to offer a professional service to tenants."[48]

47 Moody's *English Housing Associations: Lingering Downside Risks Despite Positive 2012 Results* (December 2012)
48 Montague, op cit

Chief executives mostly share Montague's sentiment. The G15, for example, are eyeing up private-sector renting as a means of cross-subsidising social rents and increasing their portfolios. With UK domestic rents at an all-time high, and in the light of uncertain stock markets and low UK interest rates, proponents say housing for rent has the capacity to generate the kind of decent low-risk returns that institutions are looking for in areas with high property values.

L&Q, Notting Hill, Sovereign, Family Mosaic and Genesis are all set to increase the number of homes they offer for private rent and are aiming to build 1,000-plus private-rental portfolios. Thames Valley Housing has also set up a new £200 million fund subsidiary called Fizzy Living geared at renting homes to young professionals, with £30 million equity from itself. It plans to attract a further £50 million of equity from institutions such as pension funds and from smaller private investors, as part of a drive to buy 1,000 new-build properties over three years.

But despite these pioneering moves, there is widespread scepticism and a great deal of caution in the sector regarding whether embarking on a private rental business is worthwhile financially. The commercial sector has traditionally eschewed private rent for a number of reasons: the rate of return, having to deal with hundreds of diverse-background tenants, the risk of reputational damage, and the risk of undermining covenants if property values fall.

Reflecting on what might happen, Savills director Yolande Barnes said: "Housing associations are well placed in terms of balance sheets to start becoming providers. For commercial developers, finance is more expensive. They also have skills overlaps and have a track record in managing large portfolios – although, pre-welfare reform, not so much experience on the rent collection side. Anything new increases risk, but on the other hand, diversification decreases risk."

Ann Santry, chief executive of Sovereign, sees more potential. "We would like to get up to 1,000 units in three years. We expect to break even on rent and we might make a small surplus. But we expect to get a high return through capital investment, by churning when the market is right. If ever at any point we had a liquidity issue, then we would sell stock as a way of raising money."

Jon Sawyer, founder of Eye Developments, said: "Private rent requires scale and high volume, because of the small margins. A thousand units feels about right."

For such developments it is difficult to get land, which needs to be bought more cheaply than with traditional market homes for sale. Financial deals can be hard to pull off too, as the appetite for investment among UK financial institutions is low. Their lack of a track record in investing in rented housing means there are few of the all-important comparators required by risk-averse investors. In addition, some institutions, such as local authority pension funds – suggested by numerous reports as a potential key investor – have other barriers. Local authority pension fund managers' fiduciary responsibilities to pension holders mean there are potential conflicts of interest in investing in local housing schemes in their own area. In addition, the financial return would have to come before any social consideration.[49]

Given the obstacles, it is perhaps not surprising, as Chris Brown of Igloo put it, that many feel "there are other ways of expending the same effort for better gain".

Angelo Sommariva, policy director at Moat, which has so far not been involved in the private rented sector, said: "The two models work differently. Social rent is typically based on a long-term model (40-60 years in some cases), whereas private rented is much more short-term. The two models are not necessarily irreconcilable, but the differences have to be carefully worked through."

Andrew Cunningham, chief executive of Grainger (the UK's largest specialist listed residential landlord), offers a few pieces of advice to social landlords embarking on private rent:

- Tenants have greater freedom to move. If they don't get a good service, they vote with their feet.
- Churn is higher but occupancy rates lower – it's vital to fill voids quickly.
- Properties need to be designed for rent, especially with a view to reducing maintenance.

Depending on underlying financial structures, volatility in values can lead to difficulties in satisfying covenants.

Interviewees also questioned whether cross-subsidy is actually realistic. As one chief executive put it: "When you look at housing associations' businesses over the years, have they really made that much money on their commercial activities, or has it been their income from social rent that has cross-subsidised their commercial activities?"

49 See: *Local Authority Pension Funds: Investing for Growth* (Smith Institute, 2012)

5.6 Extending community services – opportunities and risks

As well as extending the type and tenure of housing they are offering, associations are increasingly extending their reach into the community. Expanding their organisations in this way provides extra income and spreads overheads. And it can help extend social purpose and provide much-needed support in the wake of cutbacks in provision by local authorities and the voluntary sector.

Providing supported housing, work programmes and regeneration has long been a staple of the sector. Indeed, the National Housing Federation's In Business for Neighbourhoods campaign has been championing and highlighting members' contribution to communities for over a decade. However, there has been criticism of the way in which housing associations have been working in their communities. According to ResPublica, for example, "size has become a preoccupation for many associations. They have not been the key players in social policy and action that other players have been in our communities. For many associations, localism and support for community initiatives has simply not been a core activity. The potential of the sector to do more is immense."[50]

To extend and improve community services, housing associations are looking to be more evidence-based and efficient in the benefits they provide, measuring social value and setting up services that tap into new streams of government funding, improving the life chances of their tenants, and in some cases reinforcing their specialist services. One Housing has linked up with Islington & Camden Health Authority, for example, to provide care for mental health patients. Also in the health arena, Accord Group has acquired Direct Health, a private healthcare company based in Nottingham, which provides care to people in their own homes. Accord specialises in services for those with learning disabilities and mental health issues, as well as dementia sufferers and older people. It sees housing and service provision as complementary.

Providing a range of services to care and cater for the burgeoning elderly population is clearly a growing market for housing associations. But it is seen as a highly specialist arena and one that is difficult to make work financially, and as a result there are few new entrants.

One example, however, is Places for People; in January it revealed that it had acquired DC Leisure, which manages around 100 leisure facilities on behalf of 28 local authorities.

50 Thomas, S and Duncan, P *Acting on Localism: The Role of Housing Associations in Driving a Community Agenda* (ResPublica, 2012)

Just four weeks earlier, the 82,000-home association acquired private rented property management business Touchstone for £15.9 million.

David Cowans said at the time: "The mutual commitment of Places for People and DC Leisure to improving places and communities was the driver for the acquisition. The roots of both companies are in working in partnership with local authorities and communities to create successful places, and we are looking forward to an exciting future together."

In other moves, Gentoo is offering major support for the green agenda, becoming the first social landlord to become a Green Deal provider and supporter of the Green Deal Finance Company. It is also one of two organisations to have set up a school academy, alongside New Charter Housing Trust Group. Aster Group is exploring setting up an academy too.

Aster as a community business

Paul Smith is head of enterprise and intelligence on diversification at the recently merged Aster Group, which manages 27,000 units in the South of England. He describes Aster as "moving to a wider role – it's becoming our mainstream rather than a nice-to-have operation on the side. We have a care business which could start to move into health. We do work with schools and are currently evaluating sponsoring academies. We support community organisations and are looking at how we can be more creative in seeding social enterprises and community businesses.

"We see ourselves very much as part of the community services agenda rather than as a landlord and housing association. Housing is not the sole objective but it gives us an asset and a revenue base. We have lots of expertise – finance and HR – which we are looking at using in other capacities. I think what will happen in five to 10 years' time is that if organisations like ours make a success in the wider role, those in the landlord camp may come across."

Chapter 6

Forging new partnerships

Forging new partnerships

One of the recurring themes of this report is the need for housing associations to forge new relationships and partnerships. The consensus among interviewees is that working more closely with local authorities will be of critical importance, as councils explore their own new-found freedoms. Both councils and associations will need to work more closely with their tenants, especially over managing the impacts of welfare reforms.

6.1 Working with local authorities

Relationships between housing associations and councils have had a chequered past, in part owing to tensions over stock transfer. While there remains considerable mutual mistrust between councils and associations, the general impression from interviewees is that austerity and localism encourage co-operation. However, several chief executives commented on the way in which some London councils see associations as "walking away" from their role as providers of low-rent social housing.

The self-financing of council housing under the recently reformed housing revenue account (HRA) system is widely considered to be a positive development for housing associations. David Montague suggests that there could be major opportunities for new investment in affordable housing if councils take a more commercial approach to their HRA.

In theory, councils (especially those that are major landlords) could borrow to build, provided they have sufficient borrowing headroom. For the most part, they have the land. Housing associations have the building and management expertise, but not always the borrowing firepower and rarely the land. So the new political and economic landscape ought to make more collaboration an obvious step.

The new freedoms for councils enabled Southwark, London's largest local authority landlord, to announce in 2012 plans to build 1,000 new council homes. Lewisham says it plans to build 250 new homes – the first social housing to be built in the borough for 30 years. Elsewhere, Barking & Dagenham council has set up a special-purpose vehicle under the HRA regime which enables council homes to be built with private finance.

However, the willingness of councils to embark on large-scale new-build programmes with housing associations is unclear. Apart from anything else, many councils are likely to be cautious and not borrow to their full capacity. Recent interviews that the Smith Institute has conducted with London council housing officers, for example, suggest that there are barriers to maximising HRA rental surpluses and concerns about taking on more debt.

According to PwC, the new HRA system could unlock some £50 billion of new investment resources.[51] Richard Parker, head of housing at PwC, said: "Councils could and should be more creative in the way they use their housing assets and the net revenues they generate, even under the constraints government places on them. They can be a lot more innovative and flexible in the way they work with housing associations under the new HRA system. Time will tell, but there are real opportunities for new ways of working – and this is particularly needed in areas where there is a shortage of supply and where the economic case is proven."

Housing associations do not work in a vacuum, and it is clear from the views of chief executives that where councils are going in terms of their housing policy has an enormous impact on what associations do. According to Richard Clark, acting managing director of Local Space (an association that delivers homes mainly in east London), "relationships with the council have always been critical but will be more influential in future, partly because of localism but also if Labour returns to power". Clark sees a possibility that councils could become the key vehicles for delivery of Labour's housing strategy, should Ed Miliband win the next election. Labour's housing shadow minister, Jack Dromey, has stated that Labour does not accept the affordable rent model and "would not rule out an increase in grant levels from a future Labour government".

Some of the G15 members claim that London boroughs continue to put up barriers to new housing by making planning permission difficult to obtain. Many associations are calling on councils to release more land. London Councils disputes this is an issue and argues that London boroughs have granted permission for nearly 200,000 homes that developers have yet to build.[52]

Growing waiting lists and overcrowding will inevitably add to the pressure on associations to play their part in housing the most vulnerable, especially as resources for such groups are reduced. However, financial concerns could increase tensions between associations and local authorities. "When there were high levels of subsidy and benefits weren't capped, it was less of a concern. But now, with higher rents and

51 *Making the Most of HRA Reform* (Smith Institute/PwC, 2011)
52 London Councils' response to the Housing Stimulus Package, 6 September 2012

welfare reform, our concern is that we don't set up residents to fail," said Keith Exford. Commenting on taking on the most vulnerable tenants, he said: "We're committed to meeting housing need but now we have to be interested also in the ability of new tenants to sustain their tenancies. In fact, we are having some very difficult discussions with some boroughs that are unwilling to reconsider their nomination policies to reflect the new realities."

A new partnership across councils and housing associations in Kent could provide a model for innovative ways of working between housing providers in a region. The Kent Housing Group is unique in that it consists of 14 local authorities and 20 housing associations. According to the group's strategic adviser, Brian Horton, "This joined-up approach was instrumental in getting funding for the nearly 4,000 units under the affordable housing programme. It means we are working in a co-ordinated way rather than against each other."

The latest Kent Housing Group scheme is with Kier's property arm and Kent County Council for 150 homes across the county. The council will provide the land, while Kier (together with an international pension fund) will provide the finance, for a mix of market sale, new, rental and affordable housing. A local housing association will also be brought on board to contribute to the finance and manage the affordable properties. The construction group hopes that this collaboration between a pension fund, local housing provider, developer and council will provide a model for others to follow.

One Housing Group and North London Health Trust

One of the biggest opportunities for the sector is in working more closely with the NHS. One Housing Group is joining forces with the North London Health Trust to provide accommodation and care for people with mental health problems who otherwise would need hospital care. According to Kevin Beirne, One Housing Group's director of housing, care and support, the scheme is very cost-effective: "It costs £700 a week in a housing association home but £3,000 a week to house the same person on a ward. There are currently 25,000 people with mental health problems in hospital. If housing associations were able to house a third of those people, that could save £1 billion a year."

Beirne said that most hospitals have surplus land and that it makes sense for the housing association sector to be involved in the type of care that requires specialist accommodation because it plays to the sector's strength in providing capital support.

6.2 Partnerships with tenants

The relationship between housing associations and their tenants is at a crossroads. On the one hand, all social landlords aspire to improve customer satisfaction and performance, but on the other they have tough decisions to make on rent levels and arrears and to ensure value for money. Chief executives highlight the need to adopt new strategies to engage tenants on ways of adjusting to the welfare reforms, notably around universal credit. Some associations are also offering fixed-term tenancies for new tenants as a way of raising standards and tackling antisocial behaviour.

According to Keith Exford, "The relationship between landlords and tenants has become perhaps a bit unbalanced and we need to work towards a far clearer and more reasonable understanding of rights and responsibilities. Expectations have risen over a period of time. Although it's right that our tenants should expect a good service, most owner-occupiers couldn't afford or obtain the kind of repairs service we now offer. We've also created a whole industry in responding to antisocial behaviour – our housing managers spend a quarter of their time dealing with it, whereas in the private sector people would have to talk these things out with each other. We've been drawn into disagreements that are often intractable and take up an enormous amount of time. Is that what we should be doing? I think generally there needs to be a bit of a reality check."

Exford asked management consultants McKinsey to scrutinise Affinity Sutton's services to tenants in order to ascertain where money is being spent and consider how better value could be delivered. The process identified some activities that are time-consuming and expensive for the association to administer but have questionable outcomes. One example he cites is in the area of mutual exchange, where tenants have the right to exchange properties with each other. The relevant regulations say that these swaps must be authorised within 42 days – but associations are under enormous pressure to approve them far more quickly. Before that can be done, both properties have to be checked. "You might find a housing officer has had to drive 30 or 40 miles there and back just to find the place in a shocking condition, and then have to go back a few days later because the tenant insists they have addressed the issues of concern. Is that either reasonable or really the best use of our time?"

Laurice Ponting, executive director of communities at Genesis, has been looking at how services might evolve there. She expects that services will develop on a more commercial basis, so that everyone is given an excellent level of basic service but beyond that level people will pay extra – for example, if they want non-emergency repairs carried out at weekends. Ponting said: "Of course, aspects to do with safety, capital works to the fabric and normal wear and tear, landlords would expect to take responsibility for. But in exchange for a subsidised rent, isn't it right we should be expecting tenants to treat their property with respect and ask them to do minor repairs themselves? This would enable us to drive down costs and improve efficiency."

An approach of managing rights and responsibilities has been advocated for some time by Tom Manion at Irwell Valley, but others are now introducing the idea into their operations. One example being operationalised is at Moat, which has introduced what it calls the "Moat promise", offering three-star, four-star and five-star levels of service.

The level of service that current residents enjoy, which will be renamed the four-star service, will continue to be provided to those residents complying with all aspects of their tenancy agreement. A five-star service will be offered, upon application, to those residents that go over and above the required compliance with their tenancy by being consistently good tenants.

Moat claims this approach "is all about changing behaviour, and encouraging residents to take responsibility for their actions and a culture of payment. If we manage to convince even half of the 20% we currently estimate to be three-star residents to manage their responsibilities, it will be worth it."

Other associations will be watching the outcome with great interest, particularly since surveys have consistently shown that the quality of repairs and maintenance is the most important factor in tenant satisfaction.[53]

A number of associations (including Sovereign, Peabody, Radian and Moat) are in the very early stages of exploring flexible tenancies, whereby rent levels would change as tenants' circumstances changed. Orbit is even looking at how tenants could have the flexibility to change tenure without moving house.

Research by the LSE for Orbit Group suggests associations need to improve their service ethos and engage on a local level with the community.[54] Associations such as Aster say they are already doing this. Others, such as Notting Hill Housing, have turned back the clock to a more personal era. Andy Belton, chief operating officer of Notting Hill Housing, explained: "Staff complained that they couldn't solve anything; it became a baton-passing exercise. So we designed our services around the traditional housing

53 See: DCLG *English Housing Survey 2008 to 2009: Household Report* (October 2010)
54 LSE *Bigger than Business* (November 2012)

officer model. All aspects of housing management became the job of local teams of housing officers, each personally responsible for a patch of 125 customers.

"We ran a pilot of this new 'Altogether Better' service in two teams, each with 10 officers, for six months in 2011. As a result, satisfaction improved by 20%-25% and we've now gone on to implement the service for all of our social rented properties. Relationships with tenants have greatly improved and it's been invaluable in terms of preparing for welfare reforms. The new system also brought costs down by 10% as the staffing model is a flatter structure and has fewer management costs."

Family Mosaic's new deal with tenants

Family Mosaic has set itself a target of getting 1,000 residents back into work in five years. It wants to remove disincentives for tenants to work, by keeping all rents at low levels – including heavily subsidising its 1,400-unit affordable housing programme to guarantee low rents for families from the profits on developing homes for sale, and then investing heavily in training programmes to help tenants get on to the employment ladder. It also aims to help 500 existing tenants buy a new home and has devised a new shared-ownership scheme that waives the rent portion of shared ownership for five years.

Brendan Sarsfield, chief executive of Family Mosaic, said: "Only giving people fixed-term tenancies is part of the stick to get people back into work. We want social housing to be housing that people value. And we want to give Family Mosaic tenants a better chance than other tenants."

Chapter 7

Conclusion

Conclusion

"Housing services provider"; "social business"; "neighbourhood investor"... it's clear from these descriptions used by the interviewees in this report just how far housing associations have evolved over the past four decades. From being landlords of need in the 1970s and 1980s, they are now routinely building houses for sale, masterminding regeneration, training apprentices and supporting all manner of community groups.

The government is now urging associations to diversify and build more new homes for sale and rent for the so-called "squeezed middle". In a speech to the National Housing Federation in 2012, housing minister Mark Prisk said: "Housing associations already provide excellent services to their tenants, but have the potential to offer homes to a much wider group of people."[55] Most of the G15 housing associations are already meeting the minister's request. Some are not only large-scale developers of homes for private rent but also the owners and managers of schools, leisure centres and even, in one case, a farm – so rapid is the pace of change.

Social hearted, commercially minded

While the housing association sector is diversifying to the extent that it is hard to describe it as a sector, one thing still binds associations together: they are still using their housing asset base to act for the good of society. All the money they earn, all the surpluses they make, are ploughed back into providing and managing more homes, getting more people back into work, or caring for the ageing and vulnerable.

For the foreseeable future, associations will seek to combine a commercial mind with a social heart. As David Montague put it: "The way we do business has changed – we have more of a commercial drive – but that helps drive our social mission. We've been forced to become more independent, and that's quite liberating. It's made us realise nothing is stopping us doing what we want to do."

Most associations share Montague's confidence. But tensions are creeping in as financial pressures mount and the welfare changes take their toll. The combination of less money, less certainty and a hardening of public attitudes towards the payment of benefits to those in social housing is forcing associations to reevaluate whom they house and what they charge. A new generation of tenants will be paying much higher rents and are likely to have less secure tenancies than in the past.

55 National Housing Federation annual conference, September 2012

The drive to become more commercial is being keenly felt, but the prospect of developing next-to-no housing at target rents is pricking the social conscience too. There is a sentiment among some of the larger associations that new development for private rental should be genuinely additional rather than replacing social housing at lower rents.

For chief executives, trying to be commercial and financially astute (to secure private finance) while holding firm to the social ethos can be like walking a tightrope. There are limits to how much cross-subsidy associations can generate through properties for rent at market prices and homes for sale. Difficult choices must be made about meeting the affordable housing needs of those on low incomes and the growing numbers of younger people paying rents well above what associations charge.

Life without grant

Everyone in the sector is keenly aware that the loss of capital grant for social housing will have a lasting effect. As Keith Exford logically pointed out, "subsidised housing needs subsidy",[56] and especially in high-demand areas where private rents are high and house prices can be more than 10 times average household incomes. However, it will take time before the reduction of grant feeds through into a decrease in the rate of new housing being built.

The Greater London Authority has not given up hope of extracting cash from the chancellor for more affordable homes, and some chief executives believe the sector should not throw in the towel on the question of grant just yet. But few expect a sudden return to pre-recession grant levels.

The loss of grant funding and the squeeze on bank lending has forced the sector into finding new sources of funding, notably from the capital markets. Several associations spoke about the growth in bond financing, which is expected to increase – despite recent concerns from lenders over the impact of universal credit. According to several chief executives, housing associations are a perfect match for institutional investors seeking a long-term, steady income stream. However, there is also a view among some observers that the more private finance is substituted for public finance, the less likely government will be to provide capital subsidy.

Skills and governance

As they diversify, there are also questions over how many associations have the right

56 Presentation to the National Housing Federation affordable home ownership conference, 2010

skills sets on their boards and management teams to adapt to the more commercial environment. Will a rush to enter the private rental market or run a healthcare provider simply be creating the potential for future financial fiasco in the style of Cosmopolitan or Vestia? The message from many of those interviewed is that associations are prepared for change but will need to be much more innovative and flexible.

The regulator is calling in reinforcements to bolster knowledge and skills on its side of the fence. But when private and regulated elements are increasingly blurred, associations must live with knowing that one housing association's poor financial judgment could torpedo the credit ratings of the entire sector.

Value for money

The view of chief executives was that associations will need to take a more robust approach towards value for money, but stress that success isn't related to being big or small.

Many associations were keen to do more to sweat their assets, although even doing that is far from straightforward. As one chief executive questioned, "Do we sell off properties in expensive areas as they become vacant, to pay for several more in a cheaper location?"

Adapting to change is certainly throwing up questions about potential structural weaknesses in the sector. The need for better asset management, for example, highlighted how little is known by some associations about the state and the quality of their stock. The welfare reforms and the need to become more professional at collecting rent have meanwhile demonstrated how important it is that associations engage better with their tenants.

Some hold the opinion that the luxury of sitting on a steady stream of social rent masks the true extent of the sector's inefficiencies. Critics suggest the sector still has some way to go to match the best private-sector companies. Yet that is what it will increasingly need to do as it vies for housing management and health contracts alongside the private sector – companies that don't spend money on translation services for tenants or help to boost the life chances of their children by putting on after-school clubs.

Several chief executives suggest that cost pressures will lead to more mergers. What seems more likely is that mergers will occur to enable higher borrowing, rather than just securing efficiency gains.

Community activities

The general sentiment among interviewees was that associations have to be more business-like, but also need to be sharper about their community activities. New thinking around measuring and rewarding social value should help, although this remains a challenging area for the entire not-for-profit sector and for government.

The rise of the early-intervention approach to tackling complex social problems is opening up new opportunities for associations, particularly in regard to programmes that help tenants get back into work, or to have better health outcomes – like the pioneering approach being taken by Family Mosaic. These types of activities will encourage associations to work more closely with local authorities and with each other.

Forging new partnerships

Working closely with long-term partners and in ways that avoid associations competing against each other for land – as illustrated by the Kent Housing Group – will increasingly become the mode of operation, along with sharing services and more stock rationalisation. Innovative partnerships such as the deal between One Housing Group and Camden & Islington Foundation Trust highlight the imaginative thinking going on in the sector, in this case saving the NHS money while tapping into its large budgets to create a brand-new income stream.

The relationship between associations and their tenants is also changing, in part as a result of welfare reforms. Now that rent collection is on the line, for example, associations are having to review their engagement strategies. Interviewees mentioned the difficulties they expect to face with increasing rent areas, which will test their social purpose. As Paul Tenant questioned, are associations really going to evict tenants over small arrears? What does seem clear is that a new client base around "affordable" and private rent will demand a different type and level of housing services.

An unpredictable future

For housing associations, bound as tightly as they are to the political mores of the time, planning ahead is always difficult. Few boards can say with any certainty what will happen after 2015. On the far horizon, some see the sector creating ties with bigger charities and pension funds – even becoming their development wing. Others envisage closer links with long-term investors, such as Genesis's deal for private rent with M&G Investments.

Housing associations, of course, are not government agencies and have the option of doing very little at all. Should the going get even tougher, they can choose to pull in their horns. They might see it as a social purpose to develop homes, but as charities and not-for-profit organisations they can turn off the tap should they need to. However, board members are mindful that the government could, if it so wished, intervene to change the business environment – as it has done in the past with new policies on stock transfer and rents. Some fear, for example, a political raid on the assets of housing associations, should they fail to sweat them as much as they might.

Associations will try hard to fulfil their social purpose of providing more housing for those on lower incomes. But the general view among experts and practitioners is that the numbers simply don't add up for conventional social housing. Not all associations are comfortable with the shift away from social housing – which will remain the major proportion of the sector for some while yet.

As the welfare reforms and funding cuts start to bite, associations will inevitably find it harder to be commercially minded and social hearted. However, the general impression is that the sector remains resilient and capable of seeing out the recession. What is less clear is whether the sector will continue to expand at the rate it has or who will be living in tomorrow's housing association homes.

Annex 1

Annex 1

The report is centred around interviews with 50 individuals from the following organisations:

Affinity Sutton
Aster Group
Barclays UK (social housing team)
Catalyst Housing
Circle Anglia
Department for Communities & Local Government
Devonshires Solicitors
East Thames Group
Eye
Family Mosaic
Financial Conduct Authority
First Base
Genesis Housing Association
Gentoo
Greater London Authority
Grainger
Housing Associations' Charitable Trust
Hanover Housing Group
Homes & Communities Agency
Hometrack
Housing Forum
Housing Ombudsman
Igloo Regeneration
Local Space
London & Quadrant
London Councils
London School of Economics
Moat
National Housing Federation
Notting Hill Housing
One Housing
Orbit Group
Peabody
Places for People

Plus Dane
PRP Architects
PwC
Savills (residential research team)
Sovereign Housing Association
Taylor Wimpey
The Housing Finance Corporation
Town & Country Planning Association
Kent Housing Group
Willmott Dixon Housing

Separate contributions were also given by:

Lord Richard Best
Eamon Boylan (Chief Executive of Stockport Council and former deputy chief executive at the Homes & Communities Agency)
Nick Raynsford MP
Martin Wheatley (independent consultant)

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