THE HOUSING FINANCE CORPORATION

Investing in affordable housing

An analysis of the affordable housing sector

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Executive Summary: Investing in affordable housing

Why housing associations?

- Housing associations [HAs] are independent private sector, not-for-profit bodies that provide rented homes at sub-market rents. They also offer the chance to gain access to home ownership and provide other neighbourhood and community services.
- This has been perhaps the most successful public private partnership in the UK. HAs are subject to strong regulation to safeguard effective governance and financial viability.
- Lenders to the sector can take full security against housing assets valued according to a conservative valuation methodology.
- Private investment facilities in England total £78.5 billion and c. £85 billion across the UK.
- There are 1775 HAs managing 2.4 million homes in England[1]. HAs are likely to remain the main developer of affordable housing in the future.

Housing association activity

- 84% of HA turnover comes from social renting sub-market rents. 70% of rents are paid directly to Landlords from Housing Benefit.
- HAs also provide homes for low cost home ownership; principally shared ownership. This helps meet government objectives to extend home ownership.
- HAs also provide specialist services under the Supporting People programme and undertake regeneration and a range of community activities.
- A minority of HAs are developers of new homes. Development has included homes for social renting, now usually under the Affordable Rent Model, and for shared ownership. The latter provides cross subsidy for development of Affordable Rent. HAs also develop homes for open market sale. Due to recent government policy announcements, development of shared ownership is certain to become proportionately more important, particularly after 2018.

The history; traditional housing associations, stock transfer and private finance

- HAs developed out of the alms house movement, founded as early as the 10th century.
- In the 19th century philanthropists invested in the improvement of living conditions via housing associations such as Peabody, founded in 1862.
- Concern about housing conditions in the 1960's as evidenced by the BBC drama *Cathy Come Home* led to the founding of more inner city HAs such as Notting Hill Housing Trust.
- The 1980's saw the introduction of mixed funding based on grant and private finance as government sought an alternative to council housing, and limits on public expenditure. HAs were well placed to lead this new phase with their independent not-for profit status and the ability to borrow outside public borrowing constraints.
- The right to buy, introduced by the Conservatives in 1980, transferred over 1.9 million homes from social renting to home ownership over the following 35 years. It re-enforced pressure to find a new approach to developing and holding social rented stock, which favoured HAs. The right to buy has been revived since 2012 by raising discounts. Less than 10% of the homes sold since then have been replaced in spite of government commitments to the contrary. The right to buy is about to be extended to HAs, who will be compensated

[1] Data in the report refers to England only unless otherwise stated.

for discounts given to purchasers. The majority of HAs are confident that they will replace the homes sold under right to buy but many of the replacements will be for shared ownership rather than social renting.

- The Housing Act 1988 laid the foundations for present practice by allowing lenders to take a first charge against HA properties that ranks ahead of public grant. It also allowed payment of rent via housing benefit.
- The present mixed funding grant/private finance regime has had bi-partisan support, although originally introduced by a Conservative Government.
- The funding regime evolved with the introduction of Affordable Rent in 2011-12. Affordable Rent is let at higher rents (80% of market rent) which means that new development requires less grant. Welfare changes introduced since 2012 have led to higher rent arrears and rent collection costs for HAs.
- Traditional HAs have used private finance to fund repair and improvement to existing stock, and to develop new stock; much of it for shared ownership which amounted to 25% of HA affordable completions in 2014-15.
- Large Scale Voluntary Stock Transfer [LSVT] has been the single largest source of new HA stock over the past 20 years. 1.3 million homes have been transferred with associated private finance facilities of c. £22 billion.
- LSVTs have been promoted by the need to tackle local authority backlogs of repairs and improvements, the desire of government to reduce public expenditure by introducing private finance, and the ability of HAs to borrow outside the Public Sector Borrowing Requirement [PSBR].
- The pace of transfer has slackened across the UK but there have still been a trickle of transfers up to 2015 including Salford, Durham and Gloucester.
- As transfer HAs mature, some of them can generate enough additional asset cover to support a new development programme. The distinction between “traditional” and “LSVT” associations is eroding over time.

Tenants and tenancies

- Tenant involvement in HA decisions has long been a feature of the sector. Tenant satisfaction with HA landlords is consistently higher than with local authority landlords.
- Tenants tend to be drawn from those on lower incomes with vulnerable and disadvantaged groups well-represented. Housing Benefit plays a key role in ensuring that rents are paid, and HA income streams are secured.
- The majority of HA properties are let on an assured Tenancy. These offer security of tenure, but allow the landlord to gain possession in certain circumstances, such as non-payment of rent. Use of the assured shorthold tenancy has become more common following the introduction of Affordable Rent. Landlords can now offer fixed term tenancies.
- HA general needs rents are regulated by government. Formerly, regulated rents rose by RPI plus 0.5% which provided predictability and facilitated sound business planning. However, in 2015 the Government imposed a 1% per annum reduction in social rents for four years. This has caused HAs to rebalance development plans in favour of shared ownership and to reconsider the overall scale of new development. The Government has assured HAs that the RPI plus 0.5% formula will be restored after 2020.

Legal status of HAs

- The majority of HAs are registered societies under the Co-operative and Community Benefit Societies Act 2014 (formerly Industrial and Provident Societies) and are registered by the Financial Conduct Authority [FCA]. In addition, some HAs are companies limited by guarantee.
- The majority of HAs have charitable status.
- Financial and other information on registered societies can be found in the FCA register, and information on all HAs can be found on the website of the regulator, the Homes and Communities Agency [HCA].

The importance of regulation

- Regulation provides assurance for lenders and investors about standards of governance and promotes financial viability.
- It also secures private finance for HAs on terms that reflect the lower risk, and provides safeguards for government and protection for tenants.
- The presence of regulation is one of the major reasons why there has been no default in the sector that has resulted in loss for lenders or investors.
- Since April 2012 the Homes and Communities Agency [HCA] has acted as both the investment and regulatory authority, although with an independent Regulation Committee.
- The HCA is committed to co-regulation involving some self-regulation and tenant input. Nevertheless, the HCA has clear objectives to secure sound governance and the financial viability of HAs, and sufficient powers to ensure that these objectives are achieved. The focus on financial viability and sound governance is now stronger than ever.
- Updated in April 2015 the HCA's regulatory framework has three economic standards including a specific standard on financial viability and governance. The economic standards are proactively enforced by the HCA. In addition to the economic standards there are four consumer standards.
- The regulator has consistently intervened over many years to facilitate solutions to problems that have financial implications for the sector, and to promote solutions such as mergers where individual HAs face financial difficulties.
- A recent problem case successfully dealt with was Cosmopolitan HA, which was taken over in 2013. This case led the HCA to reassess the practice of the sector in relation to the protection of social housing assets, control by parent bodies of their subsidiaries and mergers and takeovers. The National Housing Federation has recently published a voluntary merger code following encouragement from the regulator.

Re-classification and regulation: the need for selective de-regulation

- In October 2015 the Office for National Statistics [ONS] re-classified HAs as public bodies, in the light of additional powers to intervene in relation to HA assets and management government had acquired under the Housing and Regeneration Act 2008.
- In order to restore private sector status for HAs the government tabled amendments to the Housing and Planning Bill 2015-16, which it believes will allow the ONS to reverse its decision. The amendments will enact limited selective de-regulation.

- The HA sector remains confident that the Government understands the need for robust regulation in order to maintain the confidence of lenders and investors.

Governance arrangements of HAs

- HAs are required by the regulator to adopt an appropriate code of governance and to review their arrangements annually.
- HAs are governed by non-executive boards which usually co-opt members of the executive management team.
- Tenants are usually represented on HA boards and receive appropriate training to enable them to fulfil their role. Tenants are not usually in a majority on HA boards.
- An increasing proportion of HAs pay their board members in order to help them gain access to appropriate skills and experience, although the majority of board members are still unpaid.

Income turnover and assets

- In spite of diversification, HAs still derive c. 84% of their income from rents. This proportion has changed little over the past decade.
- Despite of the government's welfare reform programme, housing benefit/universal credit remains predictable a quasi –government income stream. It contributes c. 70% of rent paid to the sector.
- Turnover in the sector was up 5% at £15.6 billion in 2013-2014. HAs turned in an increased surplus after tax in 2014 of £2.35 billion. The Gross Book Value of the sector's assets stands at £132.7 billion. The sector developed 34,500 new homes in 2013-14.

Funding new HA investment

- The Homes and Communities Agency is the grant distributing body to HAs.
- Grant is subordinated to a lender 1st charge over HA assets.
- Private finance has become the main source of investment. By 2013-14 accumulated grant totalled £45.98 billion. Drawn-down private finance totalled £52.3 billion.
- Five lenders provide most HA private finance raised via the banking sector.
- Capital markets finance and private placements total c. £19 billion.
- The biggest proportion of HA loans are long or short-term fixed rate.
- Lending is normally fully secured on the basis of a conservative valuation methodology applied to value HA assets.
- Bond issuance has risen dramatically since the onset of the banking crisis and in 2014-15 amounted to £4.1 billion, or 60% of all new facilities.
- Credit spreads have increased since the banking crisis began and the capital markets offer longer maturities of up to 30 years. Typical maturities for lending are five to 10 years.

The Housing Finance Corporation [THFC]: what we can do for investors

- THFC is the foremost aggregating funder to the HA sector.
- Founded in 1987 through a joint initiative of the Housing Corporation and the National Housing Federation, THFC has a close long-term relationship with the sector.
- THFC has a common legal status with the majority of clients, and its 10-strong board has a wealth of experience from the banking, financial and commercial sectors. It also includes

representation from the HCA and National Housing Federation, which helps keep THFC focussed on the needs and risks of the HA sector.

- THFC has an A credit rating (stable) from Standard and Poor's.
- THFC acts as principal and borrows in its own name. It on-lends immediately and only to registered providers.
- Funds borrowed are on-lent on similar interest and repayment terms thus ensuring that THFC is protected against interest rate risk.
- THFC does not take foreign currency risk.
- In all cases THFC makes its own credit assessment of potential borrowers.
- All THFC loans are fully secured and THFC is legally bound to conservatively set covenants.
- Investors to THFC benefit from a floating charge over THFC's assets; primarily secured loans to HAs and reserves.
- All THFC stocks and loans rank *pari -passu* and are further protected by a negative pledge.
- THFC covenants to investors that its operating expenditure will remain within total income on a rolling three year basis.
- THFC takes out a combination of fixed and floating charges in respect of loans.
- Asset cover requirements are underpinned by a conservative valuation methodology.

Affordable Housing Guarantee Scheme; a THFC success story

- In 2013 THFC established a wholly-owned subsidiary, Affordable Housing Finance, to implement the government's £3.5Bn Affordable Housing Guarantee Scheme (AHGS).
- The scheme provides loans backed by a government guarantee, which can be accessed by HAs at rates significantly below those normally available.
- Affordable Housing Finance has raised long term funding from the public bond markets together with the European Investment Bank to on-lend under the Scheme. As a result of the addition of a full-faith Government Guarantee, the scheme has generated a significant amount of the lowest cost long term private finance raised by Housing Associations in the last 30 years. As at March 2016 in excess of 60 HAs had participated in the programme.
- The underwriting phase of the AHGS is due to cease around March 2016, but the on-going portfolio management of AHGS will continue until 2044.

The wider picture: a brave new world?

- The intention behind recent government policy announcements is to reverse the decline in homeownership, reduce support for the private rented sector and shift affordable housing development away from sub-market renting in favour of shared ownership.
- Government policies are unlikely to succeed in reversing the trend away from homeownership but will assist many first-time buyers. The losers will be those who cannot afford to access homeownership.

Appendix; social housing in Scotland, Wales and Northern Ireland

- Scotland, Wales and Northern Ireland also have fully regulated HA sectors that offer significant investment opportunities for private finance.

Why housing associations?

What are housing associations?

Housing associations [HAs] are independent, not-for-profit bodies that provide rented homes at sub-market rents. They also offer those on modest means the chance to gain access to home ownership, develop new homes at intermediate and market rents and provide a range of other community and neighbourhood services.

The housing association [HA] sector is a diverse sector dedicated to meeting the needs of communities across the length and breadth of the United Kingdom [UK]. HAs are independent bodies. Their range of activity up to 2015 represents perhaps the most successful public private partnership in the UK[2]. HAs are well governed and managed and are subject to strong regulation to safeguard effective governance and financial viability. Crucially, lenders to the sector are able to take full security in the form of fixed or floating charges against the housing assets, utilising a conservative valuation methodology. All in all they represent a low risk investment opportunity that has already attracted an estimated £85 billion of bank and capital markets finance across the UK as a whole, over £78.5 billion of that in England alone. There are currently c. 1775 regulated HAs in England, c. 194 in Scotland, 65 in Wales and 23 in Northern Ireland. They provide a total of around 2.8 million homes of which 2.5 million are in England.

Because of the relative dominance of England in terms of HA stock and investment, references will be to English HAs unless otherwise stated.

A diverse sector

The HA sector is diverse. England has 1775 HAs providing circa 2.4 million homes but these bare figures in no way capture the complete picture. The smallest HA controls less than ten homes, the largest, around 140,000. The 61 largest HAs own 40% of the entire general needs stock. Over 90% of all stock is owned by the 900 HAs that are members of the National Housing Federation, the representative body for HAs.

The sector has grown steadily over the past twenty years through the development of new homes, and through transfer from local authorities. HAs have focussed on the development of new affordable housing since the 1980's. Until the last five years local authorities were effectively unable to build new homes and still build very few. Government policy, and in particular, the desire to lever in private finance that will not count as public borrowing, has been the driver of this expansion. While government has modified its policy on building by local authorities, the HA sector, with it's ability to access private finance, is likely to continue to be the significant developer of affordable housing in the future.

HA activity

There is significant diversity in terms of activity also:

Homes for rent

[2] HAs were re-classified as public bodies in October 2015 by the Office for National Statics. The context for this decision is explained later in the article. The decision is likely to be reversed in the near future.

The main activity of HAs continues to be the provision of affordable housing for rent. The majority of such housing is known as “general needs” or “social rented” housing. This is housing let out at rents that are substantially lower than those prevailing in the private rental market. This is achieved by providing HAs with a subsidy on the build cost of these houses via a grant from central government. Alternatively, these homes, while in local authority ownership, have been subject to historic subsidy and have subsequently been transferred to HAs under the Large Scale Voluntary Stock Transfer [LSVT] programme (see below). In addition to general needs housing HAs also manage a small stock of homes let at market rents and some at “intermediate” rent; with a degree of subsidy enabling rents to be set at a level between market rents and general needs.

The pattern of renting has been changing since 2011-12. An increasing proportion of rented stock has been let under the Affordable Rent Model [ARM] under which HAs can charge up to 80% of a market rent but receive a lower rate of grant than would have been the case when developing “traditional” social rented homes[3].

Overall, rental receipts on general needs housing are c. 85% of total HA turnover. The stability of this income is underpinned by housing benefit, which contributes around 70% of general needs rents and is paid by government direct to landlords in respect of tenants on low incomes. Housing benefit is steadily being replaced by Universal Credit, which is being phased in and which provides individual housing support within a single payment covering a number of personal benefits that are amalgamated under Universal Credit.

Until 2010 much of the requirement for private finance centred on the need to bring general needs stock up to the government’s decent homes standard by 2010; 92% of social housing stock met the standard within the timescale. Meeting this target involved very substantial investment by HAs. Although much of this investment has now been implemented, the government was still providing funding for local authorities up to 2015 under the HCA Decent homes Standard Backlog programme. Improving and updating HA stock continues to generate the need for significant investment by associations.

Shared ownership

In addition to holding rented stock many larger HAs also have shares in a stock of shared ownership homes. The first shared ownership development was in Notting Hill in 1979. Since then numbers have grown steadily and there are currently around 170,000 shared ownership properties across the country.

Shared ownership is essentially a part-buy, part-rent tenure. A household purchases an equity share (typically around 36-40%), usually with a mortgage, and then rents the remaining share under a lease from a housing association. Rents are typically between 2.5% and 3% of the share retained by the housing association, but the shared owner has full responsibility for repairs and maintenance

[3] In effect ARM allows HAs to charge higher rents and thus to borrow against a higher proposed rental income stream, thus allowing for development at lower levels of grant, or in some cases without grant. Many commentators argue that higher borrowing levels and reduced grant will contribute to the erosion of HA financial capacity over time..

even though they only own a share of the property. Shared owners have the opportunity to "staircase" [acquire a greater share of the house] by purchasing additional equity in their properties. In the majority of cases they are free to staircase up to 100% ownership. However in 2014-15, only 2.84% did so. Staircasing up to less than 100% is rare because the costs involved are often seen as disproportionate to the additional equity purchased. In practice the incomes of the majority of shared owners do not rise fast enough for them to make the leap from shared ownership to outright ownership. Shares in existing shared ownership properties can be sold on to other households and theses sales are known as resales. Most shared owner purchasers are working and only 6% were previously in social rented accommodation.

Shared ownership is not without competitors in terms of rival housing offers. The Government's Help to Buy equity loan scheme which allows a buyer to purchase a home with an equity loan of 20% and a deposit of as little as 5% has assisted some buyers who might have accessed shared ownership to buy outright.

Supported housing

In addition to managing general needs rented housing, many HAs also provide specialist services for groups such as the elderly and those with disabilities, mainly under the Government Supporting People regime. While this is a substantial activity it has not been as significant as other areas of HA activity in attracting private investment. It is often characterised as a low margin service offered by HAs and is becoming more specialised as certain HAs (such as Hanover) focus their activities in this area. Supported housing has not been seen by lenders as attractive for loan security purposes.

Regeneration

In recent years, HAs have worked with other private and public partners in a number of major regeneration projects in cities such as Liverpool, Birmingham, Glasgow and London. Regeneration draws on the expertise and experience of HAs in caring for communities and developing neighbourhoods. It involves looking at the strands that make a successful and diverse neighbourhood, including employment, housing, health, transport, education and training. Regeneration has attracted very significant sums of public and private finance, often structured in innovative ways involving consideration of the partnership nature of successful regeneration initiatives.

Serving the wider community

HAs play a major part in tackling the needs of the homeless and those with urgent temporary housing requirements, including ex-offenders and other groups with specialised needs. Initiatives such as hostels and the leasing of rented accommodation from the private sector are common to many HAs. In addition, HAs have for many years recognised their centrality in fostering communities, with involvement in childcare, training, employment, financial inclusion and various other co-operative and community initiatives. These are a testament to the extension of HA activity beyond the traditional role of general needs landlords. However, in recent years as HAs have grown and adopted a stronger business culture in response to a more challenging operating environment and less government grant for new development there is evidence that their commitment to wider community activity has waned.

Development of new homes

Only a small minority of larger HAs have consistently achieved the status of developer. In recent years grant for development of general needs housing has been focussed on a limited number of development partners driven by the desire of government to achieve maximum efficiencies for public funds disbursed as grant. In addition, the regulator has scrutinised development plans with increasing care in order to ensure that plans do not create unacceptable risks for the HAs concerned. This has been particularly true since the onset of the banking crisis and economic and housing market downturns.

As well as developing general needs housing, which has almost exclusively been undertaken under the ARM since 2011-12 (see above), HAs have, over many years, integrated development for low-cost home ownership into their plans. In practice, in most cases, this means shared ownership. This has been driven by two key factors:

- The aspiration of successive governments to increase the levels of home ownership and to develop purchase schemes for those on modest incomes to facilitate this.
- The desire of government to maximise the output of new development per unit of public grant by requiring HAs to "cross subsidise" general needs development by profits from open market sales, with funds for the latter predominantly supplied by private finance. The need to achieve cross subsidy is explicitly built into the HCA Affordable Homes Programme [AHP] 2015-18. Grant levels per unit of new affordable housing provided have been falling over the past decade, making it necessary for developing HAs to gear up and bring in additional private finance.

Shared ownership is branded nationally by government under the *Help to Buy* brand which also brands its equity loan scheme and loan guarantee scheme to facilitate higher loan to value mortgages. The proportion of shared ownership developed by HAs is set to grow under the 2015-18 Affordable Homes Programme.

The Government has announced that the Right to Buy is to be extended to housing associations (see below). It stated that homes sold under the Right to Buy are to be replaced but that they need not be replaced by social rented homes. Many HAs have intimated that they intend to develop additional shared ownership to replace Right to Buy stock. In addition, the Government announced in the 2015 Autumn Statement that from 2018 no more grant would be available for sub-market renting. Additional grant would be made available to build homes for shared ownership. Thus the proportion of shared ownership within HA development programmes is likely to rise substantially in the medium term.

The history; traditional housing associations, stock transfer and private finance

Early origins

HAs have a long and distinguished history. Their genesis is usually accepted to be in the alms house movement which provided housing for the needy by various foundations. Alms houses date back to the 10th century, and the earliest continuously surviving alms house is believed to be the Hospital of St Cross in Winchester, which was founded around 1133.

19th century; philanthropy rules

Housing associations as recognised today began to develop during the 19th century as entrepreneurs benefiting from the period of industrial and commercial expansion initiated by the industrial revolution chose to plough back some of their wealth in philanthropic projects, including the provision of housing. A good example is Peabody, still flourishing, but originally founded in 1862 by George Peabody, who donated a total of £500,000 to the Peabody Trust.

20th century developments

Increased awareness of inner city housing issues in the 1960's, as evidenced by the famous BBC drama *Cathy Come Home,* and by the founding of the charity Shelter in 1966, led to the establishment of a new generation of urban housing associations. The Notting Hill Housing Trust is a good example, founded in 1963 to address concerns about local housing conditions.

1980's: the right to buy and a new role for private finance

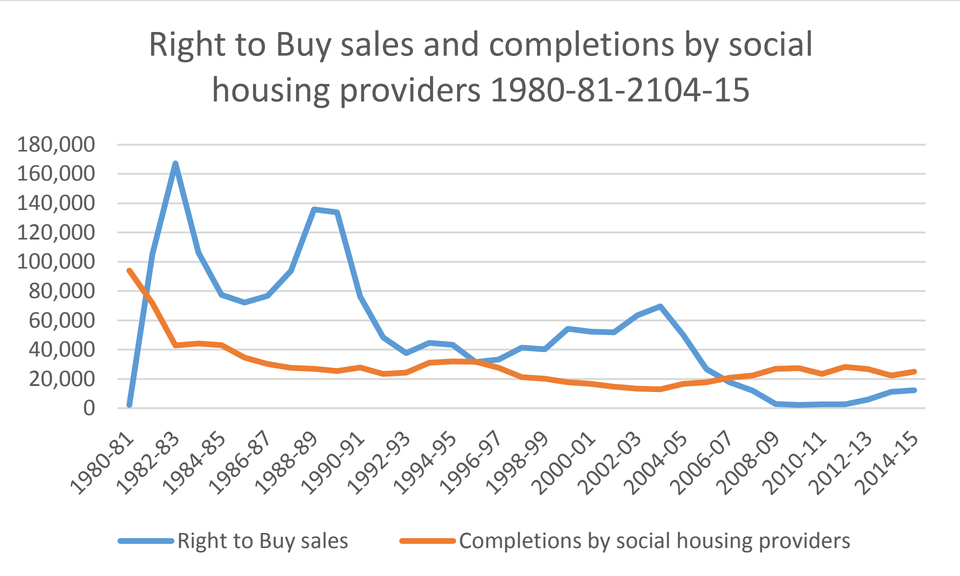
Until the 1980's virtually all social rented housing was developed by a combination of direct public subsidy and loan finance raised via the Public Works Loan Board. The election of the Conservative Government under Margaret Thatcher in 1979 led to a re-appraisal of the provision of social housing going forward. Underpinned by a strong commitment to free market economic liberalism, the Conservatives aimed to reduce public borrowing, increase efficiency and expand the role of private finance. In this context central government expenditure on housing fell sharply as a proportion of GDP during the 1980's and beyond. The new Government was strongly focussed on promoting a "property owning democracy", with the extension of homeownership as the key housing policy aim.

Another key factor putting pressure on government to find ways of funding new social housing for the future was the introduction of the Right to Buy for local authority tenants under the Housing Act 1980. Under the scheme, tenants could purchase their homes at substantial discounts and, subject to certain conditions, could subsequently sell the property on the open market. The scheme was revolutionary in conception and dramatic in effect. Since 1980/81 over 1.9 million homes have been sold under the right to Buy in England alone. The scheme was the single most important factor in increasing the proportion of home ownership during the 1980's and 1990's. As discounts under the scheme were cut back in later years, sales volumes reduced, reaching a low point of 2,375 across England in 2008-09. In November 2011, the Government announced that it would improve the discounts to purchasers under the right to buy with the aim of achieving a large upturn in sales, with one for one replacement by local authorities of the homes sold. Sales have increased dramatically in response, reaching 16,519 in 2014-15. However, the commitment to replace the homes sold under Right to Buy has not been fulfilled. Over 40,000 homes sold between 2012-13 and 2014-15 but only 3,630 were built in total by local authorities over the same period.

Until now, HAs have largely escaped the Right to Buy except for tenants of HAs created via Large Scale Voluntary Stock Transfer [LSVT]. It is true that since 1996 some tenants have been eligible for the Right to Acquire scheme, but low discounts have ensured that take-up has been insignificant in practice.

In the run-up to the 2015 general election the Conservatives announced that they would extend the Right to Buy to HAs, on the same terms as for LAs. HAs, (unlike LAs) would receive compensation for discounts given from receipts raised by LAs who would be expected to sell a proportion of their high value social rented stock. The majority of HAs expect to use sale receipts and compensation to achieve one-for one replacement of homes sold although in many cases Right to Buy homes will be replaced in whole or part by shared ownership homes rather than homes for social renting.

The right to buy substantially reduced the stock of social rented housing, (although experts argue as to exactly how much effect this had in practice), and arguably contributed to the residualisation of the tenure to one that could be accessed only by those in greatest need.



Source DCLG.

There was a strong pressure to replace the homes sold under Right to Buy, although as the chart above shows, overall this has not been achieved. The Thatcher Government sent out a clear message that local authorities were not going to be significant developers of new affordable housing and successive governments have done little to change that position in practice although the local authority housing revenue account settlement in 2012 has produced a very modest increase in local authority development levels. Since the 1980's the focus of affordable housing development has shifted decisively towards HAs.

As independent bodies, HAs stood outside the public borrowing and accounting regime. They were therefore well placed to become the focus for future development since private finance could be introduced without it counting as public borrowing as would have been the case with local authorities. The fact that they were already regulated by the Housing Corporation was an additional advantage, allowing scrutiny of their financial viability and governance, and reducing the risk to both the public purse and to providers of private finance. HAs had raised limited amounts of private finance with the assistance of the Housing Corporation from the late 1970's but the situation was somewhat chaotic, with a number of key issues unresolved.

The Housing Act 1988

The Housing Act 1988 can be seen to lay the foundations for the large scale introduction of private finance for housing associations and to facilitate the expansion of the Large Scale Voluntary Stock Transfer programme, by which stock moved from local authorities to (usually) newly-created housing associations. It formalised a regime that has endured in its essentials until the present time although with declining levels of grant.

Amongst its provisions the Act:

- Modernised the grant regime and allowed HAs to combine grant with private finance,
- Allowed development risk to be borne by HAs,
- Enabled lenders to take a first charge over HA assets and subordinated public grant to that first charge.
- Crucially the Act made possible the continued availability of housing benefit to cover rent payments as needed.

Although the 1988 Act was passed by a Conservative Government, mixed funded development and investment in existing stock by HAs has received the support of both major parties and much expansion took place under the Labour Government of 1997-2010 under the Decent Homes Programme.

From 2000 to the present day; expansion of HAs, repairs and improvements and private finance

A recent change to the mixed-funding development regime was the introduction of the Affordable Rent Model [ARM] by the Coalition Government. The ARM was a response to the fiscal austerity of the post-banking crisis period and was introduced in time for the HCA Affordable Homes Programme [AHP] of 2011-15. As noted, ARM allows for government to contribute less grant per unit with HAs charging higher rents of close to 80% of a market rent for an equivalent home. In spite of persistent fears amongst HAs and housing commentators that the requirement to lever in higher levels of private finance per unit would erode the financial capacity of HAs over time, the government was confident enough of the position to continue to use ARM to develop all social rented housing in the 2015-18 AHP, although it appears that this programme will develop significantly fewer homes than its predecessor. The announcement by the Government that HAs would be subject to a 1% per annum reduction in rents charged for four years has put further pressure on this programme as HAs struggle to manage an estimated 13% cut in planned rental income for the period to 2020.

Important changes to welfare benefits affecting social tenants and HAs have introduced by government within the past three years.

- The so-called “Bedroom Tax” or abolition of the spare room subsidy was introduced in April 2013. Ceasing to provide housing benefit to cover the element of rent relating to a social tenant’s spare bedroom has effectively created a situation where households who have lived in homes with a spare room will be under financial pressure to move. Social landlords will avoid offering homes to households where the home would provide a spare room over and above the number of bedrooms the household requires. The move has caused an increase in rent arrears and has cost HAs significant sums in attempting to re-house households who can no longer afford their rent. Rent collection costs have increased also.

- The overall cap on working age benefits was also introduced from April 2013. This limited the maximum benefits that could be paid to households. It has been the cause of significant rent arrears, although the Government has claimed that it has met its stated aim of encouraging more households to seek work. In the Summer Budget of 2015, the Chancellor announced that the overall benefit cap would be reduced to £20,000 outside London. This is expected to hit many more households than were previously caught by the cap and it is expected that rent arrears and rent collection costs will increase further as a result of the change.
- The Government has also been phasing in universal credit. This integrates a number of benefits into one. Significantly for HAs the rent component of universal credit is normally paid to the tenant rather than directly to the landlord. It is expected that rent arrears will rise very significantly, as will the costs of collection.

In the Autumn Statement 2015, the Government announced that no more grant would be available for the development of social rented housing but that grant for development of shared ownership would be substantially increased. Even before this announcement, HAs were seeking to adjust the balance within their development programmes in favour of shared ownership and it looks as if the tenure of new affordable housing will be very different going forward. These changes raise serious questions as to where the poorest households will be housed in the future, since very low income households and workless households cannot access shared ownership and social rented stock will become increasingly scarce as new development drops away and Right to Buy erodes the levels of existing stock.

Expansion of private finance 1988-2015

Since the 1988 Act came into force the expansion in the role of private finance has been prodigious. By 1991, over £2 billion of private finance had been raised by HAs. Over the following two decades this has increased to c. £78.5 billion in England and to c. £85 billion UK-wide, as analogous developments have taken place in Scotland, Wales and Northern Ireland.

Traditional (non-stock transfer) HAs have used private finance for two main purposes; repair and improvement of existing housing stock and development of new stock.

Spending on repairs and improvements has been driven by a number of factors over and above the need to provide for routine maintenance:

- The need to meet national standards and regulatory requirements.
- Enhanced awareness of environmental standards and the indirect influence of enhanced standards for new-build, such as the Code for Sustainable Homes, withdrawn in March 2015 and replaced with new technical standards.

Much of the growth of investment by private finance has been predicated upon the existence of housing benefit as a quasi- government income stream, which covers the full social rent when the tenant is eligible, which is paid direct to the landlord and which rises as rents rise. The recent welfare changes above, have been managed successfully by the HA sector but have caused some to question the degree of government commitment to the sector particularly when recent government policy announcements in respect of extension of Right to Buy and the 1% per annum rent cut are taken into account (see below).

Stock transfer

Large Scale Voluntary Stock Transfer [LSVT] has been the single largest source of growth in the HA sector during the past 28 years. 1988 saw the first stock transfer of 4,400 homes to the newly created Chiltern Hundreds Housing Association. By 2012, over a third of English local authority housing comprising some 1.3 million homes had been transferred to the HA sector. Most of this to newly created HAs but with some partial transfers to existing organisations. Total private finance facilities generated by LSVT in England had reached £21.6 billion by 2012.

There were a number of factors behind the promotion of LSTVs:

- The need for local authroities to tackle large accumulated backlogs in repairs and improvments and to meet the Decent Homes Standard.
- The desire of Government to reduce public expenditure by bringing in private finance and to promote private sector efficiencies.
- The then private sector status of HAs, keeping their borrowing outside the Public Sector Borrowing Requirement[PSBR]

Transfer, which can only take place following a ballot of individual tenants, and on the basis of an agreed programme of repairs and improvements, has contributed very substantially to improving the lives of those same tenants, through facilitating improvements to stock that would not have occured within normal public expenditure constraints. In the early stages much of the transferred stock was in the South and comprised rural and semi-rural estates. However, as time has gone on inner city homes have been subject to transfer as has much poorer stock including some of negative value, which has been transferred with the aid of “gap funding” from Government to make the transactions viable. The Homes and Communities Agency committed £464 million in gap funding for negative value transfers for the period 2011-15.

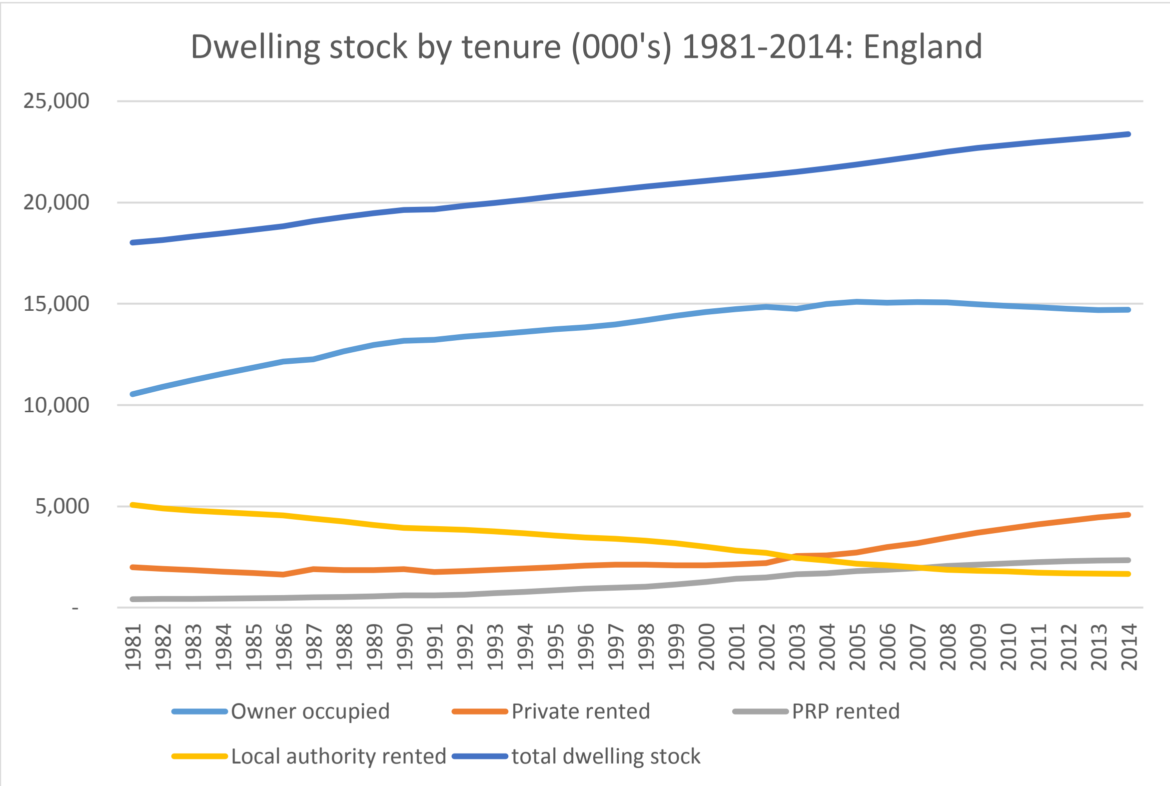
A number of factors have led to the slackening of the impetus for transfer in recent years. The fact that much of the better stock has been transferred is one. In addition, the ability of local authorities to create Arms Length Management Organisations [ALMOs] as an option to fund and manage the improvement in their stock provided a viable alternative to transfer for some. The HCA is also allocating “backlog” funding to assist local authorities who have retained their stock to reach the Decent Homes Standard. Another important factor is a settlement in relation to local authority Housing Revenue Accounts [HRA]. The settlement enables local authorities to exit the current subsidy system and paved the way for self-financing of council housing from April 2012. The settlement allows local authorities to undertake prudential borrowing and has opened the door to a renewal of housing development by local authorities. In practice LA development levels have been very modest and the limited amount of borrowing “headroom” possessed by local authorities means that HAs are likely to continue as the main drivers of new development over the medium term.

Although the pace of stock transfer has slowed there have been a trickle of transfers in recent years. LSVTs in 2015 included the transfer of 8,500 homes from Salford Council to Salix Homes, the transfer of 4,800 homes from Gloucester City Council to Gloucester Homes and the transfer of 18,500 homes from Durham County Council to Durham Housing Group.

In spite of 100% debt funded at foundation, strong regulation and sound governance have ensured that there has been no incident of financial default amongst LSVT HAs. A number of LSVTs have managed their assets and cash flows successfully enough that having completed their initial programmes of improvements they have been able to secure further funds for development. Chiltern Hundreds HA, the first transfer association founded, is an example, Bedfordshire Pilgims and Chelmer Housing Partnership are others. The maturing of transfer organisations, partial transfers to existing HAs, and mergers and acquisitions involving existing and transfer associations, have meant that the distinction between “traditional” and ”LSVT” associations, still used by the HCA for statistical purposes is becoming less relevant.

The HA sector; nearly three decades of rapid growth

Overall, the effects of new development fuelled by private finance and of LSVT have led to significant growth of the sector. The stock of HA homes has more than tripled since 1990. As the table below shows, growth in the sector has contributed to a changed balance between HA and local authority tenures and to a significant increase in the HA sector in terms of overall tenure balance, although from a low base.



Source: DCLG

Tenants and tenancies

Tenants and tenant satisfaction

Whatever diverse activities are undertaken by an HA, its tenants still form the heart of the association and its main organisational focus.

HAs have long been required by successive regulators, to consult tenants and involve them in decision making. HAs have well-developed mechanisms for bringing tenants together for consultation and many represent them on their management boards. The regulatory framework, updated by the Homes and Communities Agency [HCA] in April 2015 sets out a Tenant Involvement and Empowerment Standard requiring HAs to:

- "Provide choices, information and communication that is appropriate to the diverse needs of their tenants in the delivery of all standards
- Have an approach to complaints that is clear, simple and accessible that ensures that complaints are resolved promptly, politely and fairly. "

In fact, the English Housing Survey 2013-14 indicates that HA tenant satisfaction with the way their landlord carries out repairs and maintenance is consistently higher than for local authorities, while overall, 81% of social renters are very satisfied or fairly satisfied with their properties.

HA tenants, are, not surprisingly, largely made up of those on lower incomes. In 2014-15 the mean weekly earnings of social tenants in employment was £284.00. Vulnerable and disadvantaged groups are well represented, with lone parents with children making up 17% of households, and a high percentage of single person households. 30% of tenants are aged 65 and over. Only 24% of tenants are in full-time employment. Housing benefit is of key importance in meeting rent payments for those groups who are economically inactive or on low incomes and helps ensure that the rental income stream is secure.

Tenancy types

Although there are recently implemented changes to tenancy arrangements, the overall picture is still reasonably clear:

- **Assured tenancies.** Most tenants hold their properties under an assured tenancy. Established under the Housing Act 1988 assured tenancies offer considerable security of tenure. Nevertheless, a landlord can gain right of possession from the courts on a number of important grounds, which include non-payment of rent, causing damage to the property and creating a nuisance to other residents. While social landlords are able to offer lifetime assured tenancies, under the Localism Act 2011, social landlords are now also able to offer fixed-term assured tenancies for a minimum of a five year term.
- **Assured shorthold tenancies.** These are used in cases where needs are temporary and where a more secure tenancy would be inappropriate. Under these tenancies the landlord can gain possession without having to demonstrate specific grounds, once an initial term (usually six months) has passed. Assured Shorthold tenancies are also used as 12 month starter tenancies for those who will later be granted an assured tenancy if their starter tenancy has been conducted satisfactorily.
- **Secure tenancies.** A small proportion of tenants will have secure tenancies in line with those offered by local authorities. These tenancies must have been offered prior to 15th of January

1989, and historically HA tenancies have tended to last around five years. This tenancy type is steadily diminishing in significance.

- **Flexible tenancies.** Homes built under the new Affordable Rent Model [ARM] can be let under "flexible tenancies" [HCA]. This means that the type of tenancy that can be offered is not prescribed, so HAs can let properties on flexible terms, although tenancies must be for a minimum period of five years (two in exceptional cases). In practice, the majority of HAs let ARM homes on assured shorthold tenancies.

In the Summer Budget 2015, the Chancellor announced that that social tenants with household incomes of £30,000 per annum or more outside London and £40,000 or more in London would be required to pay a market or near market rent for their properties. This "pay to stay" provision was to ensure that scarce social rented properties are not rented by those who could afford to move elsewhere. The Government has since announced that "pay to stay" will remain voluntary for housing associations. This reversal is part of moves to ensure that government intervention in the sector does not undermine the Government's intention that the decision by ONS to reclassify HAs as public bodies be reversed (see section below).

Rent regulation

Since the 1990's the Government has regulated HA and local authority rents in England. The aims have been twofold; to gain a hold on escalating levels of housing benefit to the social rented sector, and to bring about a restructuring of social rents leading to a convergence between HA and local authority rent levels. Currently local authority rents tend to be lower than for equivalent HA accommodation. Rent regulation does not apply to market rented properties.

The formula under which rents are regulated allowed rents to rise by RPI plus 0.5% per annum and which provided a strong element of predictability in relation to the rental income stream has been suspended from 2016-17.

In the 2015 Summer Budget, the Chancellor announced that there would be a 1% pa. rent reduction imposed on social rents for four years from 2016-17. It was calculated by the Office for Budget Responsibility that this would amount to a 13% reduction compared to previously planned rental income over the four year period. This has forced many HAs to focus on their core activity and to take decisions to cancel some of their work that is of wider social benefit, such as work to promote employment and training. Many developing HAs are revising downwards estimates for new development after completion of the 2015-2018 AHP, and are shifting the balance of development both before and after 2018 away from social renting and towards shared ownership provision.

Legal status of HAs

- The majority of existing HAs are registered societies under the Co-operative and Community Benefit Societies Act 2014 and registered with the Financial Conduct Authority [FCA].

- The Co-operative and Community Benefit Societies Act 2014 replaces the 'industrial and provident society' legal form with two new legal forms:

  - the "co-operative society" and;

  - the "community benefit society"

- it also consolidates previous industrial and provident society legislation including:
    - Industrial and Provident Societies Act 1965
    - Friendly and Industrial and Provident Societies Act 1968
    - Co-operative and Community Benefit Societies Act 2003

All new HAs that would have registered as I & Ps will now register as "community benefit societies" under the 2014 act and all pre-existing I & Ps are now referred to as "registered societies under the Co-operative and Community Benefit Societies Act 2014".

Some HAs were friendly societies and are now also registered with the FCA under the 2014 Act.

The FCA operates their publically available Mutuals Public Register of the above HAs, which includes a range of information on each registered HA including their rules, the annual return and accounts, and details of floating charges.

HAs may also be established as companies limited by guarantee, and this is common where HAs have been set up to receive a transfer of former local authority housing stock. These associations will, of course, be registered with Companies House and are subject to company legislation.

Whether they are Community Benefit Societies or companies, HAs can have charitable status, and this is the case for the majority. While charitable status can confer certain tax advantages, it also places certain restrictions on how an HA carries out its business.

N.B. Although HAs are registered with the FCA or with Companies House these bodies do not regulate HAs. Their regulator, since April 2012 is the HCA. Regulation is described in more detail below.

Investors may wish to note that the HCA provides publically available information on all regulated HAs (known as "registered providers") on its website[4], including information about performance against regulatory standards, regulatory judgements and benchmarking and statistical data.

The importance of regulation

Key benefits of regulation

A great strength of the HA sector is that it is regulated. While HAs, "registered providers" themselves, sometimes complain that regulation is over bureaucratic, regulation has delivered a number of key benefits:

- Comfort to lenders and investors through ensuring minimum standards of governance and promoting financial viability, thus lessening the probability of financial default.
- Access to private finance for regulated providers at rates that reflect the perception that the sector constitutes a low-risk long term investment.

[4] www.homesandcommunities.co.uk

- Safeguards for government as a major investor, and in terms of its key objectives for the affordable housing sector.
- Protection for tenants in terms of the quality of provision and their ability to influence decisions that affect their lives.

From the perspective of investors it is important to note that regulation is one of the major reasons that there has been no incident of default by a regulated provider resulting in loss to the lenders or investors involved.

Developments and changes

Regulation has been a long term feature of the HA sector. Until December 2008 the regulator was the Housing Corporation. The Corporation regulated HAs only; local authorities were subject to different arrangements.

The Housing Corporation combined its regulatory role with that of distributing grant, thus undertaking both the regulatory and investment function.

Major changes to regulation were embodied in the Housing and Regeneration Act 2008.

The 2008 Act made provision for abolition of the Housing Corporation and establishment of two new bodies, the Tenant Services Authority [TSA] as regulator, and the Homes and Communities Agency as the investment authority.

The TSA

From December 2008 until April 2012 the TSA was the new regulator for HAs, and from April 2010 for local authorities and ALMOs.

The 2008 Act gave the TSA strong powers to regulate the financial viability and governance of HAs. This has remained a priority in practice, representing a recognition of the importance of regulation in these two areas for lenders and investors.

Recent development; the HCA as regulator

The Coalition Government that took office following the general election of 2010 took the decision to abolish the TSA. From April 2012 the regulatory role in relation to all registered providers (i.e. including local authorities, ALMOs and for-profit providers) was taken over by the HCA.

In order to preserve some independence between the investment and regulatory functions a new independent Regulation Committee was established to oversee the activities of the HCA as regulator under powers set out in ss. 178-179 of the Localism Act 2011.

The HCA describes its regulatory role in the following terms:

- "Protect social housing assets
- Ensure providers are financially viable and properly governed
- Maintain confidence of lenders to invest into the sector
- Encourage and support supply of social housing
- Ensure tenants are protected and have opportunities to be involved in the management of their housing

- Ensure value for money in service delivery”

This represents a strong focus on ensuring the sound governance and viability of HAs and in promoting value for money. These objectives re-enforce the regulatory priorities of ensuring that lenders and investors are encouraged to engage with the HA funding market on favourable terms and of protecting public investment.

The HCA takes a co-regulatory approach. While the regulator sets the standards that HAs must meet, there is also a responsibility placed upon HAs themselves to meet these standards. This implies that the regulator will intervene less in practice, with some saving in the resources required for enforcement. At the time of writing, the system has been in place for over three years and appears to have worked well, although periodically there are calls for more resources to be allocated to the regulator by government.

The HCA embodies its regulatory requirements in its regulatory standards. The Regulatory Framework contains seven standards:

Economic standards

- **Governance and financial viability**
- **Value for money**
- **Rent**

Consumer standards

- **Tenant involvement and empowerment**
- **Home**
- **Tenancy**
- **Neighbourhood and community**

The HCA will intervene proactively to monitor and enforce the economic standards; this reflects the commitment to promoting investor confidence and value for money. Proactive intervention is not the standard practice in relation to the consumer standards. Those wishing to challenge local practice in relation to consumer standards must take the issues up with their landlord and then, if not satisfied, pursue their grievance via external agencies, including their Member of Parliament. Only if there were a risk of “serious detriment” would an approach to the HCA result in action.

Governance, financial viability and the regulator

The HCA has always placed a high priority on securing sound governance and financial viability across the HA sector. The Governance and Financial Viability Standard sets out the outcomes and expectations of the regulator and makes specific reference to issues such as the relationship between a parent body and its subsidiaries and the protection of social housing assets when undertaking non-social housing activity.

> Governance and Financial Viability Standard
>
> 1 Required outcomes
>
> 1.1 Governance
>
> Registered providers shall ensure effective governance arrangements that deliver their aims, objectives and intended outcomes for tenants and potential tenants in an effective, transparent and accountable manner. Governance arrangements shall ensure registered providers:
>
> (a) adhere to all relevant law
>
> (b) comply with their governing documents and all regulatory requirements
>
> (c) are accountable to tenants, the regulator and relevant stakeholders
>
> (d) safeguard taxpayers' interests and the reputation of the sector
>
> (e) have an effective risk management and internal controls assurance framework
>
> (f) protect social housing assets
>
> 1.2 Financial viability
>
> Registered providers shall manage their resources effectively to ensure their viability

The broad, outcome-focussed statements in the standard are supplemented by a 14 page Governance and Viability Standard Code of Practice which amplifies and provides additional context. The Regulatory Framework and standards were overhauled and re-issued in April 2015.

Regulation; tested in practice

There can be no guarantee that HAs as private sector bodies will be underpinned by government in the event of financial failure. Such a guarantee would fatally undermine the private sector status of HAs, and hence their ability to borrow outside of public expenditure rules and constraints. Although HAs have recently been re-classified as public sector bodies, the Government intends that they will regain their private sector status in the near future.

Even in the absence of a guarantee, the regulator has consistently intervened to ensure that financial difficulties and risks facing HAs individually and collectively do not result in loss for lenders and investors or prejudice the interests of tenants. Such intervention can be informal and pre-emptive, building on the close relationships forged between the regulator and HAs:

- The Housing Corporation consistently intervened to promote mergers and takeovers of HAs in difficulties and has used grant to ensure that such arrangements were viable. The best known example of this is the case of Ujima, an association that became insolvent due to management and governance problems in late 2007. The Housing Corporation used its powers to organise the major creditors to agree to a takeover of Ujima by London and Quadrant with no loss to creditors.
- During the period 2008 to 2009 the HCA diverted very large amounts of grant to enable developer HAs to retain properties built for open market sale, but which did not reach predicted sale values, or which could not be sold. Intervention by the HCA assisted HAs to cope with, and substantially reduce, a backlog of over 10,000 unsold new-build properties.
- In early 2009, due to falling interest rates, unexpected margin calls by lenders on standalone swaps taken out by HAs as part of their hedging arrangements, threatened to cause financial problems for a number of associations. The TSA met with lenders and was able to reach an understanding that resulted in those lenders exercising sufficient flexibility that HAs were able to deal successfully with a difficult situation. The HCA continues to monitor the position on standalone swaps in the HA sector and to report regularly on the current situation on its website.
- In 2011 Cosmopolitan Housing Group merged with Chester and District Housing Trust. Shortly afterwards serious liquidity problems were uncovered and difficulties emerged in relation to a student lettings business undertaken by a Cosmopolitan subsidiary. There was a perceived risk of default by Cosmopolitan. The HCA as regulator intervened to promote talks with lenders and with other HAs who might provide assistance. After protracted talks Sanctuary HA took over Cosmopolitan in March 2013.

Against the backdrop of a more challenging lower grant operating environment for HAs the Cosmopolitan affair raised serious issues about the activity of subsidiaries and their capacity to put social housing assets at risk. This raised issues about board control of parents and subsidiaries. It also raised questions about the risks and opportunities created by takeovers and mergers. These questions have become more salient as many HAs are believed to be considering merger as a way to strengthen their organisations to deal with the impact of the 1% per annum rent cut imposed by the Government. The HCA revisions to the Regulatory Framework reflect the lessons of Cosmopolitan particularly in relation to safeguarding of social housing assets. In November 2015, the National Housing Federation launched its own voluntary merger code following encouragement from the HCA. The code is based on 10 points which set out how a board should evaluate merger proposals and how the merger process should proceed. In February 2016, Sanctuary HA, the organisation which took over Cosmopolitan, rejected the new merger code, raising the question as to whether the code will be fully effective.

The response of the HCA to the problems at Cosmopolitan and the interventions by successive regulators over the past decade should provide comfort for investors that the sector continues to be well-regulated. Lenders and investors to the HA sector are more concerned that the rigour of the regulatory regime itself is maintained alongside adequate resources to enforce that regime. It is believed that Government fully understands the importance of maintaining the integrity of regulation.

Reclassification and regulation: the need for selective de-regulation

Until October 2015, HAs were defined as private sector organisations. Although they may receive grant aid from government and are regulated by a Non Departmental Public Body, the HCA, HA finances were deemed by the Office for National Statistics [ONS] to stand outside the public income and expenditure regime. Their borrowing did not therefore contribute to public debt. This has been a key factor in the continuing commitment of government to provide grant (albeit at lower levels) for development by HAs, since grant can be supplemented by investment by private finance on a scale that was not been possible with local authorities. It should also be noted that while the regulator has, in practice stepped in to facilitate resolution where HAs have encountered financial problems, there is no formal State underwriting of HA finances. On 30th October 2015, the ONS announced the re-classification of HAs as public bodies. Henceforth they were to be classed as Public Non-Financial Corporations. The trigger for the decision was a re-appraisal of the increased powers that government had acquired over Private Registered Providers (principally HAs) under the Housing and Regeneration Act 2008. These increased powers revolve around the power to dispose of HA assets, and powers to intervene in the management of HAs.

The decision that HAs are public bodies effectively means that spending and borrowing by HAs contributes to the public finances. In practical terms the immediate impact is limited, because this is essentially an accounting decision. However, in the longer term there are fears that government could be minded to exercise more control over the management and finances of HAs because of the potential impact of their activities on the public sector borrowing requirement and other aspects of public finances. Ultimately, the Government could direct HAs to seek funding via the Public Works Loan Board rather than negotiate for private finance as other private sector organisations do.

The present Government is ideologically opposed to extending the public sector and has no wish to further burden public finances. The Government indicated in November 2015 that they wished to enable the ONS to reverse the re-classification of HAs and have introduced de-regulation amendments to the Housing and Planning Bill currently going through Parliament.

These amendments effectively remove the need for HAs to obtain the consent of the regulator to dispose of stock and further limit the circumstances under which grant can be recovered. they also lessen the degree of control when constitutional changes are made by HAs. The new “pay to stay” regime under which HAs were to be required to charge higher rents to higher income social tenants will be voluntary on HAs rather than compulsory.

The Government has also moved amendments to introduce a new administrative regime based on “Housing Administration Orders” in the event of the insolvency of an HA. The new regime allows the Secretary of State (or regulator with the consent of the Secretary of State) to apply to the courts for a Housing Administration Order. It is the court rather than the Secretary of State which has the final power to determine whether an Order will be granted. The aim of the Orders is to ensure that the insolvent organisation’s social housing remains within the regulated housing sector and to achieve this by rescuing the HA as a going concern and/or arranging transfers of undertakings. The Housing Administrator, appointed under the order, is an officer of the court (rather than an appointee of the Secretary of State). The new regime provides an opportunity for a Housing Administration Order to be granted before other conventional insolvency procedures such as administration, can be invoked. The Government has moved to reassure lenders to the sector that their interests will be protected.

The intention is that these measures will be sufficient to prompt the ONS to reverse its previous decision.

The Government has to tread carefully in order to strike a balance between providing robust enough financial regulation to satisfy lenders and investors to the HA sector and reducing its powers sufficiently to satisfy the ONS. The measures introduced in the Housing and Planning Bill should not undermine regulation in the key areas for investors and lenders; securing sound governance and financial viability. In spite of the need for selective de-regulation to secure the private sector status of HAs, the sector is confident that the Government understands the need for robust regulation to provide confidence for lenders and investors.

The governance and financial characteristics of HAs

Governance arrangements of HAs

The influence of the regulator has led to sustained pre-occupation with achieving sound governance across the HA sector. Under the new HCA regime this concern with governance has been maintained. All HAs are required to adopt an appropriate code of governance and to review their governance arrangements and accountabilities annually.

HAs are governed by non-executive boards. Usually HAs will also co-opt members of their executive management team including the Chief Executive and Finance Director as board members. Most HAs have tenant board members, and stock transfer associations are required to have tenant board representation as well as board members drawn from local authorities whose stock has been acquired. Tenant board members are normally elected by tenants and HAs will have a programme of training to ensure that they are able to discharge their responsibilities properly. Tenant members do not form a voting majority on the majority of HA boards.

HAs are expected to ensure that they have an appropriate range of skills and experience on their boards to enable them to oversee their activities properly. Board members were traditionally unpaid. Occasionally there were problems in attracting potential members with appropriate skills. As HAs have become larger more complex organisations, and as their diverse activities, notably in development, have exposed them to new risks, this problem has become more serious. In 2003 the regulator took the decision to allow HAs to pay board members. A survey conducted in succeeding years suggests that the proportion of associations paying board members is steadily increasing, particularly amongst the large HAs. A survey conducted for the National Housing Federation in January 2013 identified 106 HAs paying board members and Chairs, with the latter typically receiving payments of between £5,000 and £25,000 per annum.

An increasing number of HAs are now part of group structures that are intended to provide economies of scale and to facilitate certain activities such as new development.

It is often said that HA governance tends to be over bureaucratic and over reliant on a plethora of detailed written policies and plans produced in response to regulatory guidance. In spite of the frustrations that the above administrative tendencies may cause, they do at least have the advantage of ensuring that HA boards are fully aware of their aims and objectives. In addition, the required attention to longer term planning, particularly for those undertaking significant development and refurbishment programmes, does provide genuine comfort to investors. HAs may not always be agile decision makers, but their attention to detail tends towards lowering their risk profile and lessening the chances of default against covenants.

Income, turnover and assets

Rents

In spite of the diversification of HA activity, associations remain predominantly dependent on rents for income. Rents on general needs housing amount to c. 84% of the turnover for the sector. Until 2015, the Government rent regime made this this income stable and predictable, with annual rises of RPI plus 0.5% on average. However, following the Government's decision to cut social rents by 1% per annum for four years there is now significant uncertainty about the future. The Government has committed itself to restoring the previous regime of RPI plus 0.5% after 2020.

Housing Benefit/Universal Credit

The existence of Housing Benefit has been a key stabilising factor for the HA sector. Housing Benefit has contributed some 70% of rents collected by HAs. Housing Benefit has been considered a quasi-government income stream, which was secure and which ensured that rent levels were affordable for tenants. Subject to means testing, Housing Benefit in the social rented sector usually covers the whole rent payable. It is also usually paid directly to the landlord, thus reducing rent arrears and keeping the costs of collection down. This is facilitated by the tenant waiving their right to receive housing benefit personally at the time they first claim it. However, the situation is changing. Universal Credit is being phased in whereby all benefits eligible to the household, including rent, are paid directly to tenants. HAs are reporting increased rent arrears and higher costs of rent collection.

Other aspects of The Government's welfare reform programme include the so called "bedroom tax" and the overall benefit cap. These have been discussed above.

Housing Benefit/Universal Credit remains a key factor in enabling HAs to collect rents from low-income households without excessive collection costs. While it is not the seamless safety-net it once was, the effect of the various welfare reforms will be monitored by HAs, lenders and investors.

Turnover and assets

Turnover for the sector continues to increase. According to the HA G*lobal Accounts 2014* turnover rose by 5% to £15.6 billion from £14.9 billion the previous year. The surplus from property sales was £630 million in 2014, up by 35% over the previous year. Operating costs increased by 4.5% million to £10.6 billion. The sector turned in an overall net surplus of £2.35 billion, up from £1.93 billion the previous year. Total net assets increased by 10.3%, with the Gross Book Value of housing properties increasing by 5.3% to £132.7 billion. The sector developed around 34,500 new housing units during the year.[5]

The regulator gave this positive assessment on the basis of the 2014 Housing Association Global Accounts:

[5] Homes and Communities Agency, *Housing Association Global Accounts 2014,* HCA, London 2015.

> "The sector remains an appealing lending prospect for both the banks and capital markets, with the strong asset base, predictable income streams and government support through Housing Benefit and regulation combining to produce favourable pricing."

Funding new HA investment

In the absence of conventional equity investment two main sources of funding are available to HAs for investment.

Grant

The Homes and Communities Agency [HCA] is the agency with overall responsibility for investment except in London, where this role has been given to the Greater London Authority. The HCA distributes social housing grant to HAs under the government's Affordable Homes Programme [AHP]. The current AHP for 2015-18. As a single investment agency with a broad remit, the HCA also undertakes the full range of investment related activities from land assembly for development to administration of the various *Help to Buy* home purchase schemes. As austerity in relation to government finances bites harder the reliance on private finance grows. The HCA uses grant as an equity type resource, which can be flexibly deployed to maximise the leverage of other investment from HAs, local authorities and other stakeholders. However, the HCA does not want to prejudice HA viability through ill-considered action in respect of grant. While, grant levels under the AHP 2015-18 are lower than for the 2011-15 AHP, the HCA will still have distributed some £3.3 billion in grant over the period of the programme.

Historically, social housing grant was the most important source of investment funding for HAs, a position maintained until relatively recently. The Housing Act 1988, formalised the structures of a mixed funding, grant/private finance regime. Grant is subordinated to the private lender 1st charge against HA assets (fixed or floating). Therefore, in the early days private finance essentially had the status of a "top up" to grant funding. Social Housing Grant levels were at 75% in the early 1990's. The main exception to this position were the wholly debt funded LSVTs.

Government has increasingly promoted the use of grant to lever in the maximum private finance as a way of maximising outputs from any given level of public expenditure. Over the past two decades grant levels have fallen, initially in England but later in Scotland and Wales, although to a lesser extent. The Affordable Rent Model [ARM] of funding effectively substitutes a demand-side subsidy in the form of higher rent (backed by Housing Benefit) in return for a lower level of grant funding. This has allowed grant levels to fall significantly. The Government has announced that there will be no further grant for development of Affordable Rent homes after 2018, but it has pledged itself to promote the development of 135,000 additional shared ownership homes by 2020-21. The shift towards shared ownership development and away from development for sub market renting can be seen as reflecting the broader policy aims of the Government to promote homeownership. Given the long-term trend for grant rates to fall and the Government's exclusive commitment to shared ownership, the current chronic shortage of social rented homes is likely to get progressively worse, particularly as HAs will probably replace a significant proportion of social rented stock sold under the extended Right to Buy with shared ownership properties.

What is clear is that falling rates of grant over a sustained period have led to private finance taking on the pre-eminent funding roles. Accumulated grant investment in properties in 2014 amounted to a total of £45.9 billion. However drawn down private finance had reached £52.3 billion.

Private finance

By Q2 2015-16 total private finance facilities for HAs in England had reached £78.5 billion of which £64.7 billion had been drawn down according to the HCA *Quarterly Survey of Private Registered Providers.* While the majority of existing facilities are still in the form of bank or building society lending, the capital markets have markedly increased their importance in terms of new facilities compared to a decade ago. According to the *Global Accounts 2014,* total debt raised in the year to March 2014 was £5.6 million of which £2.5 million was bank lending and £2.9 million was raised on the capital markets. More recently, the HCA *Quarterly Survey* shows the capital markets funding and private placements providing 27% of new facilities in Q1 2015-16 and 30% of facilities in Q2.

Traditional bank lending has been dominated by five banks:

- Lloyds Banking Group
- Barclays
- Nationwide
- Santander
- Royal Bank of Scotland

In spite of this dominance smaller players such as the Newcastle Building Society have entered and exited the market periodically. The Yorkshire Building Society provides an example of a relatively recent entrant that is reported to be set to expand its lending to the sector.

Lending has mostly been fully secured, with assets valued by a conservative valuation methodology, which usually involves general needs housing being valued by a combination of two prudent approaches. Existing Use Value-Social Housing [EUV-SH] values on the assumption that a property will remain tenanted at a subsidised rent after disposal. Open Market Valuation [OMV]-Tenanted values properties on the basis that they continue to be rented after disposal but at market rents.

The capital markets have always had a significant place as providers of HA investment with current capital markets finance and private placement facilities to the sector in excess of £19 billion. Investment has involved single name bonds issuance via a number of arrangers predominantly led by: Royal Bank of Canada, Barclays, Royal Bank of Scotland, Lloyds, HSBC and Santander. Private placements have also played an increasing role. Smaller HAs have been able to access the capital markets via aggregating bodies who have grouped requirements together. THFC is the pre-eminent body in this category, with a consistent history that stretches back to the dawn of the present mix-funding finance regime.

Capital markets issuance and private placements rose dramatically in value in the wake of the banking crisis. The cost of funds to banks has risen and allowed capital markets investment to compete effectively on price. Credit spreads for HAs have increased dramatically from the 20-30 basis points over LIBOR offered immediately before the banking crisis. In addition, stronger regulation and the need to re-build their balance sheets have forced the banks to curtail their appetite for the long-term (up to thirty year) facilities they used to provide. Typical bank lending today might be for a five year term at 100-150 basis points over LIBOR. The situation for the banks has been aggravated by the fact that many loans taken out before the banking crisis are at rates which no longer reflect the cost of funds to the banks themselves. Although HAs have held on to these loans where possible, in many cases they have been forced to re-finance in order to escape restrictive terms attached these loans. All this has opened up opportunities for investors to offer long term funding of up to thirty years at competitive rates. A significant proportion of this funding has been used to re-finance existing bank lending but it has also been used to fund new projects.

The above factors have combined to radically change the balance of new long-term HA investment towards the capital markets and away from the banks. This has been assisted by the recognition by many investors that HAs represent a "safe haven" offering secure long-term returns. The strong relationship of THFC with the regulator and with the HA sector itself has ensured that THFC/Affordable Housing Finance[6] has taken full advantage of this upturn in capital markets activity:

HA public bond issues since January 2011

	Nominal Amount (£)	Rating	Date Issued	Term (Years)	Spread over Gilts	Cost of funds	Moodys BCA
THFC Funding No 3	55,200,000	A+/-	Apr-13	30	1.38 %	4.31%	
Saffron	125,000,000	-/A2	Jul-13	35	1.12 %	4.64%	baa2
THFC Funding No 3	81,500,000	A+/-	Oct-13	30	1.05 %	4.50%	
A2Dominion	150,000,000	-/-/AA-	Oct-13	9	1.05 %	4.50%	
Sanctuary	150,000,000	AA-/A1	Oct-13	33	0.78 %	4.20%	a3
Grand Union	150,000,000	-/A2	Nov-13	30	1.14 %	4.63%	baa2
Peabody Capital	350,000,000	-/A2	Nov-13	40	1.05 %	4.63%	baa2
Aster	250,000,000	AA-/-	Dec-13	30	1.05 %	4.60%	
Chelmer	200,000,000	AA-/A2	Dec-13	30	1.25 %	4.79%	baa2
Southern (draw £49m in 2019)	50,000,000	-/A1	Jan-14	30	1.27 %	5.36%	a3
Southern	125,000,000	-/A1	Jan-14	25	1.20 %	4.55%	a3

[6] Affordable Housing Finance is a wholly owned subsidiary of THFC, which handles lending under the Government's Affordable Housing Guarantee Programme (See below).

East Midlands	200,000,000	AA-/-	Feb-14	30	1.08 %	4.60%	
Notting Hill Housing Trust	250,000,000	AA/A2	Feb-14	40	0.98 %	4.47%	baa1
Thrive	125,000,000	AA-/-	Mar-14	37	1.15 %	4.68%	
BPHA	200,000,000	AA-/-	Mar-14	30	1.35 %	4.82%	
GB Social Housing	47,700,000	A-/-	Apr-14	25	1.50 %	4.82%	
Radian	200,000,000	-/A1	May-14	30	1.20 %		a3
Radian	100,000,000	-/A1	May-14	35	1.27 %		a3
Affordable Housing Finance	208,000,000	AAA/-	May-14	28	0.37 %	3.76%	
Town and Country	80,000,000	AA-/-	Jul-14	31	1.35 %	4.67%	
Boston Mayflower	150,000,000	AA-/-	Sep-14	45	1.30 %	4.30%	
A2Dominion	150,000,000	-/-/AA-	Sep-14	12		4.50%	
Cross Keys	150,000,000	AA-/-	Sep-14	31	1.20 %	4.30%	
Walsall	250,000,000	-/A2	Oct-14	31	1.25 %	4.28%	baa1
Guinness	100,000,000	-/A1	Oct-14	30	1.30 %	4.00%	a3
Yorkshire	200,000,000	-/A2	Oct-14	30	1.35 %	4.23%	baa1
Affordable Housing Finance	198,000,000	AAA/-	Oct-14	28	0.38 %	3.30%	
Wheatley	300,000,000	AA-/-	Nov-14	30	1.60 %	4.40%	
Herefordshire	120,000,000	-A2	Nov-14	35	1.38 %	4.19%	baa1
Riverside	250,000,000	-/Aa3	Nov-14	28	1.35 %	4.00%	A2
Paragon	250,000,000	-/A2	Jan-15	32	1.40 %	3.63%	A2
Richmond Housing Partnership	175,000,000	AA/-	Jan-15	30 avg life	1.17 %	3.302 %	

Swan	250,000,000	AA-/-	Feb-15	33	1.30 %	3.63%	
Affordable Housing Finance	194,000,000	AAA/-	Mar-15	27	0.32 %	2.92%	
Orbit	250,000,000	-/A1	Mar-15	30	1.15 %	3.61%	a3
GB Social Housing	16,800,000	A+/-	Mar-15	24	2.00 %	3.88%	
Affordable Housing Finance	208,000,000	AAA/-	Aug-15	28	0.40 %	2.89%	
Metropolitan	250,000,000	AA-/-	Sep-15	30	1.67 %	4.20%	
London & Quadrant	250,000,000	AA/A1	Oct-15	34	1.35 %	3.84%	a3

Source: THFC

Total capital markets funding in 2010-11 was less than £1 billion. In In 2011-12 this figure rose to £1.5 billion. By 2014-15 the figure was £4.1 billion, representing 60% of all new facilities agreed during that year. This compared to a market share of 52% of all new facilities granted the previous year. Although by Q4 2015 banks still held 74% of all existing facilities granted to HAs they were no longer the dominant players in terms of new business.

The Housing Finance Corporation [THFC]: what we can do for investors

Who we are

THFC is the foremost provider of aggregating funding services to the HA sector. We specialise in aggregating the private finance requirements of HAs in order to enable those associations to gain access to financial markets on the most competitive terms.

THFC obtains funds from bond issues, (public issuance and private placements) and bank loans including funding from the European Investment Bank [EIB]. We raise funds for new HA development, for repairs and improvements to existing stock, for regeneration and for other related purposes.

THFC was established in 1987 through a joint initiative of the Housing Corporation, the National Housing Federation [NHF] - the trade body for housing associations, and the private sector. This sector initiative can be seen as in part a positive response to analogous developments in the retail mortgage market, with the National Home Loans Corporation- a centralised lender raising its funds on the capital markets, having been founded in 1985. THFC has had, from its inception, a close and creative relationship with the HA sector.

What we are

As a registered society under the Co-operative and Community Benefit Societies Act 2014

THFC has a common legal status with the majority of clients. As a registered society, THFC is registered with the Financial Conduct Authority and our key financial information is publically available from the FCA as well as from ourselves.

Our 10-strong Board of Directors includes a wealth of experience from the banking, financial and commercial sectors but crucially also includes representation from the HCA and the NHF. This ensures that our strategy and organisational focus is centred on our clients and informed by a strong awareness of their operating environment including risks, opportunities and the long-term trends.

The THFC Group currently has a total loan book of £4.154 billion and declared an annual surplus of £4.062 million (after tax) in March 2015.

Share equity in THFC is purely nominal, but the Group had accumulated reserves of £20.63 million at March 2015.

While not completely immune to the fallout from the banking crisis, THFC, throughout its 28 year history has demonstrated that it is a counter-cyclical credit. THFC is a well-managed organisation, with strong risk assessment and a conservative approach to the setting of loan covenants, which were not relaxed in the boom years before 2007. Unlike many of its bank and building society competitors THFC did not need to receive public funds to shore up either liquidity or capital during the crisis. THFC has remained profitable throughout the period 2007 to the present and indeed has been in surplus since its inception in 1987. We are poised to take an expanding role in funding the HA sector going forward. We held our A+ long term credit rating (stable) from 2004 until after the UK referendum vote to leave the EU in June 2016. Following the downgrade of the UK credit rating following the "leave" vote it was inevitable that re-evaluation of other institutions including THFC would follow. In the event our rating was adjusted from A+ to A. The "stable" outlook applied by S & P reflects what the agency describes as the "intrinsic creditworthiness" of THFC.

How we operate; THFC and investors

Funding mechanisms

Over the years we have used a variety of financing instruments including zero coupon, deep discounted, index-linked and conventional public debenture stocks, private placements and fixed and variable rate bank loans. In spite of our flexibility we adhere to some fundamental principles:

- THFC acts as principal and borrows in its own name. It on-lends immediately and only to registered providers.
- Funds borrowed are on-lent on similar interest and repayment terms thus ensuring that THFC is protected against interest rate risk.
- THFC does not take foreign currency risk.
- We always make our own credit assessment of potential borrowers.
- Our loans are fully secured and we are legally bound to conservatively set covenants.
- Investors to THFC benefit from a floating charge over THFC's assets; primarily our secured loans to HAs and our reserves.
- All THFC stocks and loans rank pari passu and are further protected by a negative pledge.
- THFC covenants to investors that its operating expenditure will remain within total income on a rolling three year basis.

Overall, THFC offers investors flexibility, a secure long-term investment and guaranteed return through participation in the affordable housing sector; a well-regulated and low risk environment representing one of the most successful long-term private public partnerships in the UK.

THFC and borrowers

HAs wishing to access the services of THFC benefit from our unrivalled links with the HA sector and our role as a specialised lender, we *only* lend for affordable housing. With both the HCA and NHF represented on our board, THFC is well-placed to look at an HA in the round and within the context of the broader sector. That means we understand HA aspirations and the risks they face; we are keen to help, but not in ways that ultimately rebound on the borrower, the investor or the HA sector as a whole.

Credit appraisal

We undertake rigorous credit appraisal of our borrowers prior to loans being approved by our Credit Committee. Over its entire 28 year history THFC has had a 100% record of timely payment of interest and principal.

As might be expected, THFC examines key financial ratios and performance indicators drawing on our own well-developed credit criteria.

Our two stage assessment process does not discriminate in favour of larger associations. All applicants are assessed in terms of their individual financial strength and the existing exposure of THFC and other lenders to the organisation.

Asset cover

THFC takes a conservative view of asset cover; our loan security must be valued at 150% of the loan secured. Security is provided by land (including housing on land and development land), depreciated at cost in the balance sheet or independently valued at less 1.5 times the value of all loans already secured against that land.

THFC either takes a floating charge over the entire assets of the borrowing association, or a fixed charge over specific properties owned by the association. Floating charges offer greater flexibility to dispose of properties in the normal course of business, but also assist investors to achieve recovery in the unlikely event of a default by the association.

When an association's security is based only on fixed charges THFC requires a current open market valuation of the charged property in its tenanted state. Typically, this will produce a valuation of between 50% and 70% of the vacant possession value of the same property. THFC's secured loan must accordingly represent not more than two thirds of the tenanted value of the charged property. Within 18 months of loan draw down, 90% of the associated fixed charges must be provided through fixed charges on property.

In cases where floating charges are provided as security, THFC requires a similar tenanted valuation of the charged property if the asset cover for the loan in question calculated by reference to balance sheet values falls below 300%. The balance sheet calculation of assets for this cover test includes housing land and buildings at cost, adds net current assets and deducts both provisions and 150% of all other secured loans.

THFC has to date typically required that associations providing floating charge security also give fixed charges in favour of THFC over the properties on which THFC's loan is utilised. This is, however, not an obligation required by the terms of the Trust Deeds under which THFC operates. HAs have the option to switch from floating to fixed charge-only security and vice versa with THFC's consent and subject to fulfilment of the appropriate covenants, including execution of any necessary deeds of variation to change the borrower's loan agreement.

Following amendment to THFC's trust deed arrangements, in certain circumstances THFC is now able to offer borrowers who have taken out loans derived from the same stock, globalisation of security arrangements. This enables borrowers to aggregate security portfolios, allowing for more efficient use of assets.

The conservative approach to asset cover ratios and in particular to valuation methodology offers investors working through THFC real comfort in terms of reduced risk.

Income cover

THFC requires that loan documentation sets appropriate conditions to ensure that all associations are able to meet loan specific interest payments. With fixed charges as security, the net income from the properties charged must at least provide 100% income cover. For floating charges, at least 100% cover must be available from within the income and expenditure account of the association.

So what does THFC offer investors?

- **The services of the pre-eminent aggregating lender to the HA sector.**
- **Unrivalled knowledge and experience of the HA sector, through our status as a specialist lender and our direct links to HAs and the regulator.**
- **A well-managed loan book with strong covenants and sound risk management.**
- **A track record of continuous independent profitability and viability from inception, through the banking crisis and beyond.**
- **A proven funding methodology that minimises risks to investors and to THFC itself.**
- **A flexible approach that combines fully secured lending based on conservative valuation methodology, with the ability to meet the needs of different groups of investors and borrowers.**

Affordable Housing Guarantee Scheme; a THFC success story

In the context of tightened credit conditions (particularly for long-term finance) for the housing sector in the wake of the banking crisis, the Department of Communities and Local Government [DCLG] announced its intention to launch the housing guarantee scheme in September 2012.

The two schemes had two aims. One was to promote purpose built homes within the private rented sector [PRS]. This was consistent with the then Government's policy of encouraging institutional investment in the PRS, which had been growing rapidly, mainly as a result of investment by individual buy-to-let landlords. The overall aim was to provide a government guarantee for up to £10 billion of loans.

The Affordable Housing Guarantee Scheme (AHGS) was intended to lower the cost of funding in substitution of additional grant funding for the development of affordable housing, defined as housing for Affordable Rent and housing for low-cost homeownership (shared ownership). The intention was to guarantee loans over the period of the programme thus providing additional finance at a lower cost of funds.

The programme involved the Government providing guarantees on loans, which could be accessed by Private Registered Providers [PRPs[7]] for schemes which did not form part of the AHP 2011-15; these schemes were therefore additional to existing grant-funded development plans and additional grant of £450 million was made available to support the programme.

THFC was invited to bid to administer the programme and raise funding for the loans to be offered. THFC was successful in the bidding process via a wholly-owned subsidiary Affordable Housing Finance [AHF] and AHF was offered a license in June 2013.

The scheme was originally scheduled to run until 2014-15 with all new homes to be completed by March 2015. However, the scheme was later extended until March 2016, with all completions at latest during 2016-17.

AHF raised long term funding from both the public bond markets and the European Investment Bank and has administered the programme very successfully up to the present time.

As of January 2016, £1.23bn of long term Bond and European Investment Bank (EIB) funding has been drawn under the AHGS. Bond average long term cost of finance has been 3.25% or Gilts + 0.36%. EIB average long term cost has been lower, at: 2.52% or an *average* of 0.14% above the UK Government's own cost of funding. Because EIB passes on its own, very low, funding costs to the AHGS, individual HAs borrowing under the EIB Facility have been able to take advantage of particularly favourable funding conditions. The lowest cost of funds obtained by a single HA from EIB under the AHGS has been 0.15% *below* the UK Government's borrowing rate at the time. This is by far the lowest cost of long term funding achieved by *any* HA in the 29 years of private finance in the sector.

So it was a surprise to the sector when it was announced in the Autumn Statement that the Guarantee Scheme would not be renewed and would be closed to bids for funding on 31st March 2016. One can see the decision to wind up the schemes as a consequence of changed government policy priorities, even though the AHGS has succeeded in its own terms. The new Government's overriding commitment to homeownership has made them less sympathetic to promoting the PRS and wary of competition between buy-to-let landlords and first-time buyers. The announcements in the Summer Budget, reducing tax concessions for individual landlords and freezing local housing allowance can also be seen in this context. The Government has also shifted grant funded development under the AHP decisively in the direction of shared ownership rather than Affordable Rent so that the terms of the guarantee programme would have had to be modified in any case. The new policy emphasis on promoting new housing supply via Starter Homes built by private developers may also be a factor.

[7] PRPs are the organisations registered with the HCA as their regulator excluding local authorities. Most PRPs are housing associations but the category also includes various community-led organisations such as cooperatives and Community Land Trusts [CLTs].

While there is disappointment at the ending of the scheme, THFC can take pride in implementing the scheme within a short timeframe and administering it successfully. The AHGS provides another example of THFC's ability to intervene successfully in the affordable housing market and to administer innovative funding solutions.

The wider picture: a brave new world?

The approach of the June2015 General Election, led to a series of Conservative housing policy and housing related announcements, which have been confirmed by the new Government and which taken together are transforming the environment within which the affordable housing sector must plan and operate.

The various proposals span the full spectrum of housing policy:

- The Right to Buy is to be extended to housing associations [HAs] with a consequent requirement on local authorities [LAs] to sell off their most valuable stock in order to compensate HAs for the discounts given on sale. The compensation arrangements are contained in the Housing and Planning Bill, currently going through Parliament. Right to Buy discounts were also increased in 2015.
- A 1% reduction in social rents per annum for four years announced in the Summer Budget. This departs as it does from a previous agreement to raise rents using an inflation-based formula. The proposal will lead to a cumulative reduction in planned rental income of c. 13%.
- A new "pay to stay" arrangement for social tenants on higher incomes of over £30,000 pa and £40,000 in London. This was widely expected to increase take up of the Right to Buy amongst higher earning social tenants but the Government has now amended the housing and Planning Bill so that the scheme will be voluntary for HAs.
- The freezing of Local Housing Allowance [LHA] for four years.
- A new 3% surcharge of Stamp Duty Land Tax for private landlords and restrictions of tax allowances in respect of repairs/maintenance and mortgage interest.
- The reduction in the overall benefit cap from £26,000 to £23,000 in London and £20,000 outside London.
- A freeze on the level of working-age welfare benefits for four years.
- A re-focus of new grant provision away from sub-market renting to shared ownership, which will also benefit from additional grant being made available.
- Removal of HA pre-emption rights to find a buyer for an existing shared ownership property on resale, where the shared owner has acquired 100% equity in the property.
- Higher income thresholds for shared ownership eligibility and a sweeping away of additional restrictions.
- Expansion of the target for the Starter Homes Initiative from 100,000 to 200,000 homes to be built by private developers, with further planning concessions and additional funds to acquire the necessary land.

Taken together these various initiatives can be seen as a response to fiscal austerity involving cuts and caps in public expenditure. However, from a housing perspective there is a real shift in focus which has major implications:

- A drive to reverse the fall in homeownership. An overriding commitment to boost homeownership, which has been falling since 2003 can be seen as at the heart of the above proposals. The extension of the Right to Buy re-enforced by the "pay to stay" proposals sits firmly within this context. The Starter Homes Initiative is intended to assist first-time buyers and is thus added to the exiting Help to Buy products. The decision to exclusively allocate grant for shared ownership development is again a measure to promote entry into homeownership.

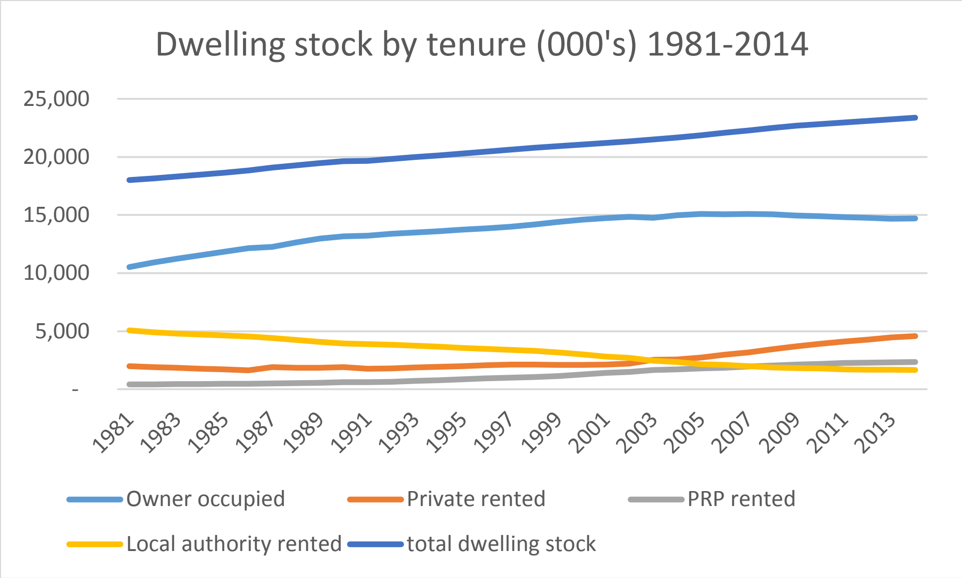
- A curtailment of support for the private rented sector. The rapid growth in the private rented sector since the late 1980's has been seen by successive governments as essentially a benign market-driven response to de-regulation of the sector. The expansion has been driven by buy-to-let landlords encouraged by the ready availability of competitively priced mortgage loans. However, the Government has become concerned at what is seen as competition between individual landlords and first-time buyers, who tend to access properties at similar price points. In addition, the Government has increasingly seen investment in the PRS as coming from institutional rather than individual investors. Institutional investors are seen by government as able to provide standards of accommodation and service that buy-to-let landlords cannot.

- Acceptance of further decline of the social rented sector. The extension of the Right to Buy will reduce the stock of social rented homes as many properties sold under the Right to Buy will be replaced by shared ownership. In addition, local authorities will have to sell off a significant proportion of their high value stock. The 1% reduction in social rents appears to be prompting HAs to shift development away from Affordable Rent towards shared ownership. This tendency will be re-enforced by the Government decision to allocate grant exclusively to shared ownership in future.

Government policy; broader implications for housing markets

The most striking aspect of the changed policy priorities set out above is the strong focus on home ownership. In itself, this is not new; successive governments have promoted increasing homeownership since the 1980's. In part this has reflected the continuing high levels of support for home ownership. Surveys consistently suggest that around 80% of households aspire to become homeowners. However, another element in the motivation to promote homeownership has been a neo-liberal policy agenda that sees individuals increasingly taking on responsibility for providing services and welfare that would previously have been the role of the state. Building up assets amongst lower income groups via homeownership has been seen as an essential component of that strategy.

The irony is that while governments have vigorously promoted increased home ownership, the level has been falling for over a decade.



Source: DCLG

Since 2003 homeownership has been in decline. The causes are complex and in some instances interrelated:

- Full-time secure employment is less prevalent.
- Labour mobility is greater, impacting on home ownership as a relatively inflexible tenure for those on the move due to high transaction costs and the risk of illiquidity during market downturns. Security of employment has been significantly reduced in practice with a similar impact.
- The tax system, no longer provides fiscal incentives for home owners
- Pension provision has been undermined in recent years, leading to downsizing or exiting the sector by older owners.
- State support for those unable to pay their mortgage in the form of Income Support for Mortgage Interest [ISMI] has been less comprehensive since 1995.
- Personal indebtedness including student loans and negative equity has undermined the ability of some households to enter or sustain home ownership.
- Affordability has been stretched by a shortage in housing supply.

The present Government has explicitly committed itself to reversing the decline in home ownership, but how realistic is this aim? Taking the increase in total housing stock into account the number of homes in homeownership would need to increase by in excess of 100,000 homes a year by new development or transfer from other tenures simply to maintain the current proportion of the stock in homeownership.

The Starter Homes Initiative is intended to produce around 40,000 additional new homes a year. There has been considerable scepticism amongst housing commentators whether this figure will actually be achieved. It has been argued that some developers may simply switch some of their proposed development into Starter Homes. There has been cynicism about whether the promised 20% discounts will turn out to be genuine and whether sufficient has been done to overcome planning constraints and the perceived shortage of development land. Even if the Government does deliver on its target, this would not be sufficient in itself to reverse the proportionate decline in home ownership.

The extension of Right to Buy will boost homeownership, particularly as local authorities will also be forced to sell high value stock into the private market as a consequence. Right to Buy sales could run at substantially higher figures than recent local authority Right to Buy Sales (c. 12,000 pa) because of pent-up demand, enhanced discounts and the fact that the stock is newer and often more attractive. Nevertheless, the overall impact is hard to estimate and is unlikely to amount to anything like the numbers seen in the 1980's.

The changes in the focus of new development towards shared ownership will also make a contribution to the level of homeownership but given that total completions by HAs over the five years to 2014-15 averaged just under 25,000 homes a year, the impact is likely to be limited since shared ownership already makes up a significant proportion of new HA stock. Additionally, in spite of government predictions, overall completion numbers may not be maintained after 2018. Many HAs are reporting that development programmes will be reduced in size after the present AHP is completed.

Overall, while the Government may succeed in temporarily reversing the numerical decline in homeownership as a tenure it is unlikely to reverse the steady shift in the balance of tenures away from homeownership. To achieve that, the Government would have to address some of the fundamental issues listed above.

As the chart above makes clear, the reduction in the level of homeownership has been accompanied by a corresponding rise in private renting. This has been driven by de-regulation (The creation of the Assured Shorthold Tenancy under the Housing Act 1988) and the availability of mortgage finance for buy-to-let. However, there are longer term factors at play:

- Increasing immigration leading to a need for rented housing for those newly entering the UK.
- Increasing student numbers.
- Greater labour mobility
- A higher incidence of relationship breakdown, single person and single parent households, all giving rise to the need for the flexibility of private renting.
- The development of a stratum of young affluent professionals putting off home ownership until later than had been customary.

In spite of the pre-occupation of government and local authorities with "rogue landlords" standards have improved in the sector and in 2008 the government-commissioned Rugg Report reported that the sector generally was performing satisfactorily.

The present Government's move to reduce buy-to-let investment in the sector would appear to be driven more by an ideological commitment to homeownership than by analysis of current trends in tenure and housing need. The PRS has served a need, particularly for younger lower income childless households. If the expansion of the sector is to halt or slow, it is not clear where these households will be housed unless a substantial increase in homeownership can take up the strain. This may happen for some if the Government is successful, but many of those housed in the PRS are unable to access homeownership because of low or insecure incomes or benefit dependency. These households would access the social rented sector if there was not already a chronic shortage of social rented homes. If growth of the PRS is slowed or halted and the social rented sector continues to decline, there is the prospect of real unmet need amongst lower income households, many of whom will be working.

The chart above shows that the social rented sector has been in decline for over three decades. The Right to Buy has eroded stock throughout that period. The mixed-funding model, was never able to deliver the numbers of social homes consistently developed by local authorities during the post-war period. In the thirty years to 1980 around 50% of all new homes were delivered as social rented housing. Since then the average has been less than 20%. Development by the commercial sector has not increased to fill the gap.

The decline in social renting is set to accelerate following recent policy announcements. Development of new social rented housing under the AHP is likely to reduce sharply particularly after 2018. The extension of the Right to Buy will cause stock to reduce further as much replacement stock will be for shared ownership. This raises real questions about where the poorest households will live. Even if the PRS continues to expand, there is evidence that private landlords are becoming increasingly unwilling to house tenants requiring housing benefit or universal credit. This phenomenon will only worsen as landlords become aware of the cap on local housing allowance.

Overall, the new policy environment is something of a brave new world. Some households may indeed be assisted to access homeownership. The decline in the level of homeownership may be slowed but the price could be real hardship for those for whom the housing ladder represents a step too far.

Appendix: social housing in Scotland, Wales and Northern Ireland

Scotland

Scotland has traditionally had a proportionately larger social rented sector than England with 24% of all Scottish homes in the social rented sector. Of these the majority remain in local authority hands, with 194 registered HAs holding a total of 277,000 homes or 11.0% of all stock.

Scotland has had some 20% of social rented stock transferred from local authorities to HAs including over 80,000 homes transferred from Glasgow City Council to the newly formed Glasgow Housing Association in 2003. Nevertheless, the LSVT programme was never as popular as in England, and appears to have come to a halt.

Although Glasgow is an exception, Scottish associations tend on average to be smaller than English HAs. Scotland has its own regulator The Scottish Housing Regulator, which undertakes a similar role to that of the HCA. Regulated HAs are known as Registered Social Landlords [RSLs]

Although grant levels in Scotland remain higher than in England, by 2015 Scottish HAs had attracted over £4.32 billion of private finance.

Scotland has its own distinctive policy agenda which can differ significantly from England. For instance, The Housing (Scotland) Act 2014 abolishes the Right to Buy in Scotland.

Wales

In Wales in 2013-14, HAs, known as Registered Social Landlords [RSLs] hold c. 144,000 homes or 10% of Welsh housing stock. The social rented sector as a whole in Wales comprises some 232,000 properties or 17% of the total stock.

The LSVT programme in Wales was delayed for a number of years due to political factors but finally got off the ground with sufficient momentum that the majority of social rented stock is now owned by HAs rather than local authorities. However, LSVT programme has slowed in Wales as in England.

In Wales the HA regulator is the Welsh Assembly Government. A new and improved regulatory framework has been introduced following some previous criticism from lenders and others about the quality of regulation in Wales.

RSLs have a modest development programme, which completed 671 homes in 2013-14 and 837 in 2014-15. Welsh local authorities have only completed 20 new homes in the past ten years.

Northern Ireland

Northern Ireland has a different structure for social renting to the rest of the UK. In the 1970's in a move to remove sectarianism from public housing provision, all local authority housing was placed within a new organisation, the Northern Ireland Housing Executive [NIHE]. At one time the NIHE was the largest landlord in Europe. In spite of erosion of stock due to the Right to Buy, the NIHE still holds some 85,000 properties.

HAs in Northern Ireland hold around 32,000 properties i.e. 4.2% of the total housing stock. Northern Ireland HAs are regulated by the Department for Social Development [DSD] within the Northern Ireland Executive.

Because of fears of a return to sectarianism and the popularity of the NIHE there was no LSVT programme in Northern Ireland. Northern Ireland continued to have relatively high levels of public expenditure compared to the rest of the UK, and this has staved off the need to lever in private finance to the same extent as elsewhere in the UK. However, in the current climate of austerity Northern Ireland faces significant cut backs in public expenditure. This, and a demanding housing development target, has contributed to a heightened interest in private finance amongst Northern Ireland HAs. The NIHA estimated in 2014 that the region requires development of 1500 affordable homes per year simply to meet ongoing demand and 2,000 homes per year if significant inroads are to be made on the waiting list for properties.

DSD is currently working through its Social Housing Reform Programme, initiated in 2013. The programme has as its aim:

> "To explore the potential for the reform of housing structures ... with a view to securing consensus on the way forward".

The remit of the programme involves examining structural reform of the NIHE, including its landlord functions and regional functions. It also involves examining a number of policy reforms including social rents, tenant participation, local government engagement, regulation and inspection of social housing providers and the housing functions of DSD itself. A tenant participation strategy has been published and progress on a new regulatory framework has been made.