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LAYING THE FOUNDATIONS FOR THE FUTURE OF AFFORDABLE HOUSING

ROUNDTABLE WRITE-UP

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"There's a lot we don't know. But what we do know, is that we won't have council housing as we knew it after the Housing Bill, and councils have to act smart to stay ahead"
EXECUTIVE DIRECTOR OF REGENERATION AND HOUSING, LONDON BOROUGH

INTRODUCTION

In collaboration with Capsticks LLP, NLGN hosted a roundtable discussion on ways in which councils and housing associations can collaborate to build more homes. This paper is the outcome of this discussion and reflects the debate by the participants.

England faces an unprecedented housing crisis. House prices have grown faster here over the last 40 years than in any other European country. Even for those on the living wage, 98 per cent of homes were unaffordable in 2014.[1] For those on the average salary, only 9 per cent of homes are affordable.

Beyond the barriers people face getting onto the property ladder, there is also a crisis of affordability in the private rented sector (PRS). In England, households living in this sector spend on average 6 per cent more of their monthly expenditure on housing than social renters, and almost twice as much of their monthly expenditure on housing than owner occupiers. Over a fifth of the poorest 10 per cent of households are now privately renting.[2]

For many years the twin pillars of central planning and the market have been seen as the mechanisms to solve this crisis. But they have obviously failed significant portions of the population. Successive waves of centrally set targets have not delivered the quantities of housing necessary, or increased the supply of affordable housing. A steady decline in public investment in new council housing has been ongoing for over 30 years. As the speculative housing industry boomed, we came to rely on planning agreements to meet need, failing to address systemic issues of house price inflation as developers drip-fed markets to keep prices artificially high.[3]

The current government, in shifting political emphasis further towards home ownership, have ploughed huge amounts of money into the private housing market, subsidising credit through quantitative easing, underwriting mortgages, providing credit to private landlords, extending Right to Buy discounts and offering tax breaks to Housing Benefit. Yet collectively these have done little to

1 Guardian (2014) Interactive Map – Housing Affordability in England and Wales http://www.theguardian.com/society/ng-interactive/2015/sep/02/unaffordable-country-where-can-you-afford-to-buy-a-house

2 Strong, L. (2015) Private Rented Housing: Problems for Tenants on a Low Income. Competitions and Markets Authority, Blog. Available at: https://competitionandmarkets.blog.gov.uk/2015/03/13/private-rented-housing-problems-for-tenants-on-a-low-income/

3 Adams, D. Leishman, C. CLG Housing Markets and Planning Analysis Expert Panel: Factors Affecting Housing Build-out Rates. CLG and the University of Glasgow. Available at: http://www.gla.ac.uk/media/media_302200_en.pdf

alleviate the affordability problem, and have in some places exacerbated it. Further, they have squeezed and immobilised many housing associations, by reducing and freezing their rental income and changing the nature of the benefit system (for example through the so-called Bedroom Tax or Spare Room Subsidy) in ways which fundamentally alter how they are able to plan and operate.

In this context, a sustainable solution is essential, and it is councils who hold the power and resources to understand their local environment enough to create much needed change. Devolution of planning for housing and recent small increases in the capacity of local government to borrow for housing present real opportunities for local actors to collaborate with the wider industry. They can work to shape local markets to create more genuinely affordable places which can attract and retain communities who will deliver meaningful growth to their economies.

This discussion considered how housing associations and local authorities can thrive in this context by sharing skills and resources for mutual benefit. Beyond having the potential to provide more genuinely affordable housing, joint ventures are shown to present an opportunity for capital investment which can support revenue expenditure, especially when design is geared towards integrated service provision. We will continue to explore how local government and housing providers can work together formally and informally to provide suitable homes for flourishing communities.

REACHING AFFORDABILITY: THE POLICY CONTEXT

After a post-war boom of social house building from the 1940s to 1970s tailed off in the 1980s, the 1988 Housing Act was enacted in order to widen the choice available to those in housing need. To this effect, the Act restructured the financial setup of charitable housing bodies, allowing them to increase their access to private finance and expand provision. Meanwhile, building by local authorities declined as they lost access to their rental income through reform of the Housing Revenue Accounts (HRAs). This, combined with a decline in public subsidy for council housing and an expansion of the Right to Buy policy causing continued drain of stock to the private market, contributed to an ongoing decline in council housing numbers.

In 2012, the HRAs were effectively transferred back to local government, and despite some fairly hefty caps, councils have been better able to borrow against this fund which has seen a small increase in the numbers being built. However, other factors – in particularly Right to Buy – have continued to skew the market. Since 2012, 35,000 council houses have been sold – while only 4,000 have been built.[4]

4 LGA (2016) Press Release: 80,000 council homes could be lost by 2020. Available at: http://local.gov.uk/web/guest/media-releases/-/journal_content/56/10180/7668062/NEWS

In the noughties, local government was increasingly expected to negotiate with market housing providers to secure policy objectives. At this time, social housing was increasingly a pre-condition of planning, where councils use their Section 106 powers to ensure either provision of units for social rent, or land from developers to build council housing.[5] However, this strategy has been hindered since the economic crisis in 2008, and more so since 2010 as central government demanded that local authorities take a presumption in favour of development, ensuring that their requirements would not affect project 'viability'. After a long debate about whether it is acceptable for developers to make viability challenges to social housing requirements without opening their books, just one council – the London Borough of Greenwich – have now made it mandatory for developers to do so.[6]

As authorities have shrinking reserves to cover the costs of appeals and decreasing back office staff to evidence housing market needs assessments, developers have been increasingly able to challenge the need to deliver social housing onsite. In more expensive areas, this has resulted in a preference for commuted sums whereby developers pay local authorities to provide social housing offsite, allowing them to maximise revenues onsite. While this allows projects to go forward, and increases profitability for leading speculative housing market actors, it does not de facto create affordable housing and does not produce mixed tenure communities.

In the July 2015 Summer Budget the Chancellor announced that rents in the social housing sector would be reduced by 1 per cent a year for four years, equivalent to a 12 per cent reduction in average rents by 2020-21. This has left housing associations in serious financial trouble. Further, welfare reform measures include a cap of £20,000 outside of London and £23,000 in the capital. In turn, many residential providers are putting a moratorium on investment. As a result, new strategies to secure social housing are imperative.

CHANGING TACTICS PART I: COUNCIL COMPANIES

Over the last three years, many councils have been learning how to do things differently. This is essential to meet the challenge of an ongoing statutory responsibility to house people in priority need, while central funding for council housing is cut and housing associations are paralysed. One strategy councils have adopted to resolve this is setting up their own housing companies.

5 Gallant, N. (2000) Planning and Affordable Housing: From Old Values to New Labour. *Town Planning Review*
6 PSE (2016) Council Bans Developers from Keeping their Affordable Housing Studies Confidential Available at: http://www.publicsectorexecutive.com/Public-Sector-News/council-bans-developers-from-keeping-their-affordable-housing-viability-studies-confidential?utm_source=Public+Sector+Executive&utm_medium=email&utm_campaign=6740360_PSE+Bulletin+Feb+16+wk+1&dm_i=IJU%2C40GW8%2CGQWLR0%2CEI3XE%2C1#.VrTYtkkDgdc.twitter

The London Borough of Ealing started this, when in 2013 they set up council-owned company COCO to develop 500 homes over the following five years. The model allowed the council to take on more debt than permitted by the borrowing caps on its HRA. Ealing had a £200 million cap, under which it had £54 million of headroom for new projects. However, their project ambitions would cost £58 million. By setting up COCO and transferring land to it, the company sits outside of Ealing's Housing Revenue Account, allowing increased borrowing. The company will develop houses for sale, shared ownership or shared equity projects, affordable rent and market rent properties, reflecting a mix of tenures. Ealing adopted this model to remove the risk that any new affordable rent homes would be bought by tenants under the revitalised Right to Buy policy - which offers London tenants a discount of £100,000.

Following suit was the London Borough of Newham, which, for London, have a relatively high and cheap supply of land. They set up a company called 'Red Door Ventures', a council owned housing company which aims to create privately-rented homes. They then use the profits to subsidise other homes at an affordable rent and fund wider council services. They are therefore using capital investment in housing as a means to generate revenues for wider activities. They also set up a company called Local Space by transferring a handful of council properties, which the company could then use as asset leverage, to gain private finance which would fund the purchase of more properties. Local Space renovate these properties and lease them back to the council as temporary accommodation. This has increased the council's temporary stock to almost 1,500, allowing homeless families to stay in decent accommodation while the council find them a more long-term solution.[7] In the longer term, they plan to use these properties to generate a surplus to be reinvested in supply, or turn them into social housing to secure benefit savings.

These approaches are becoming more widespread with similar models in Cambridge, Sheffield, Southwark, Newcastle, Brighton and elsewhere. A survey last summer found that 12.5 per cent of local authorities have already set up a housing company and 34 per cent were actively considering the idea.[8]

Councils are motivated principally by finding long term solutions to the housing problem, and secondarily by the potential income generated as a form of supplementary revenue. However, there are some limitations of the council company model. For instance, commercial acumen may be lower than in collaborations with other actors, and the company may be pushing the boundaries

7 Newham Council (2014) National Crisis, Local Action: Making a Real Difference in Housing. Available Online at: https://www.newham.gov.uk/Documents/Misc/National-CrisisLocalAction.pdf

8 Nieuwstat, H. (2015) Councils Setting up Housing Companies – a Survey. 3Fox International. Available at: http://socinvest.co.uk/report.pdf

of some council policies, particularly as they effectively self-regulate during the planning processes. In workshops with existing council company ventures, the 'thorny issue of the company appealing their own authority was raised on several occasions'. Further, setting up a company has significant associated costs. For instance, despite having no direct staff, Ealing's COCO will face taxes and annual administration costs of £100,000 plus fees for external audits, IT provision and final accounts.[9]

For these and other reasons explored here, authorities are also turning to partnership routes. Rather than creating their own housing companies, they are collaborating with local housing associations to combine forces and share skills and resources. This can have significant advantages for both parties.

CHANGING TACTICS PART II: JOINT VENTURES

The Localism Act made it easier for local authorities to invest in joint ventures with housing associations, developers, house builders and private investors. However, in practice partnerships between local authorities and actors with private interests have not always worked seamlessly, due to the divergent interests of the parties involved which can result in tensions and legal difficulties. Although local authorities and registered social landlords have grown apart over the last few decades, their interests remain closely aligned. The challenges outlined above – the reduction in social housing rents and cap on welfare outside of London – poses a serious threat to both housing associations, who will not be able to meet debt requirements, and local authorities, who may not be able to afford to meet their statutory duty to provide housing to those with 'priority need'.

Without a viable alternative, housing associations may simply dry which would precipitate a crisis unprecedented in post-war Britain. This will particularly impact in high-demand areas such as the South East, where relying on the sometimes slow and reluctant contributions of private developers is proving insufficient to meet high levels of need. Beyond putting the vulnerable at risk, this slowdown in new affordable housing supply could also stifle local economies.

Brighton and Hove Council were particularly aware of this, having been told by their local business community that a lack of affordable housing was one of the most important constraints to the labour market. House price inflation in Brighton is close to 11 per cent each year as a result of 4000 Londoners moving to Brighton annually, as the cost of a season ticket is more affordable than property in the capital.

In turn, 72 per cent of households in Brighton and Hove cannot afford market housing,

9 Duxbery, N. (2013) Ealing to Establish Development COCO. Inside Housing. Available at: http://www.insidehousing.co.uk/ealing-to-establish-development-coco/6529377.article

either to rent or buy, without some form of subsidy or spending a disproportionate amount of their salary on housing costs. Supporting low and middle income workers was not only important for key public services, but also to the competitiveness and productivity of the Brighton City Region. This is particularly relevant for workers in the digital economy, the expansion of which has been a central component of their devolution bid. They therefore recognised that affordable housing was not only a moral or statutory responsibility – but a necessity for growth and retaining their economic USP.

A LIVING WAGE HOUSING MODEL

One of the key concerns raised about the definition of affordability in the 2010 Spending Review is that it understands affordability as a relationship between homes within a market area, rather than a relationship between local people and those homes. In Brighton, they recognised that this definition would exclude and ignore some of the people most important to their economy. In turn, they decided to adopt a different strategy and work towards a 'Living Wage Housing Model'. This includes an ambition for 1,000 homes with an even split of studio, one, two and three bed flats, designed to Code Level 4 to keep running costs low, 25 per cent of which are to be built to Lifetimes Homes Standards, and 5 per cent built to wheelchair standards.

The need for a mixed tenure strategy was considered critical to creating diverse and sustainable communities. In turn, projects will comprise:

- Properties for rent and for sale that are affordable for households earning the new National Living Wage, with housing costs (mortgage or rent and service charges) set capped at 40 per cent of household income.
- Increased shared ownership using a cross subsidy model, whereby traditional shared ownership is affordable to households on the average Brighton wage.

To rent housing at 40 per cent of income for households on the National Living Wage is the equivalent of approximately 60 per cent of market rental prices. This 20 per cent difference from the 80 per cent policy cap on affordable rents will be subsidised through money from commuted sums (developer pay-offs for not delivering social housing in their own developments), and traditional shared ownership sales. Commuted sums are negotiated on a case by case basis, but provide a sustainable source of subsidy.

To achieve this, Brighton and Hove are considering a proposal from housing association Hyde Housing to establish a 50:50 joint venture. Both parties will invest equity and land. The aim would be to develop 1000 homes and it is estimated that future cash flows will generate a significant net surplus which could be reinvested in further development.

EMBRACING SERVICE INTEGRATION

At the time of the discussion, Brighton and Hove council have not decided – with any finality – what they will do with their half of this annual net surplus. Whether this will be invested in future projects of a similar type, ring fenced, or used to support general revue expenditure is yet to be decided. However, the council are keen to use future housing as a lynchpin to address other systemic social problems which have a knock-on effect on wider service provision.

Beyond providing for their aging population, Brighton and Hove are also keen to address other social challenges. The relationship between housing and substance misuse,[10] and housing and mental health,[11] have been clearly identified and they see scope to address these challenges through the project over the long-term.

Brighton and Hove also see this as an opportunity to achieve their skills objectives as a component of their devolution deal. The project business plan will support over 60 apprenticeships, 400FTE construction jobs each year for the next 5 years, 4,500 direct and indirect jobs supported by construction, and after leakage and displacement, over 2,600 net jobs for the city. Beyond the direct surpluses, the local authority will also receive new council tax revenues and New Homes Bonus.

COLLABORATION: DEFINING THE OPPORTUNITY

“Housing associations have expert knowledge of the diversity of options beyond straight public ownership – ultimately, they have more commercial acumen” COUNCIL LEADER

Housing associations and local authorities have traditionally shared a common goal: securing affordable housing for those in need. Having a shared vision and institutional remits helps engender strong collaborative action. There are a number of benefits of housing associations and local authorities working together.

- **PROTECTIONS OF BEING A SEPARATE LEGAL ENTITY.** As a joint company sits off the balance sheet, it doesn’t touch either members’ gearing (debt related to equity capital). As the assets are not listed to either party, they are also not presently subject to Right to Buy.

10 Evans, G. et al (2000) Housing Quality and Mental Health. Journal of Consulting and Clinical Psychology, Vol 68(3) p 526-530

11 Glasser, I. William, Z. (2003) Homelessness and Substance Misuse: a Tale of Two Cities. *Substance Use & Misuse* 38.3-6 p 551-576.

- **MODEL STILL SUPPORTS HOME OWNERSHIP AND HETEROGENEITY**
  By using shared ownership strategies, local authorities and housing associations can support central government's policy goal to help all citizens progress towards home ownership without compromising their ability to provide housing to those in need over the long term. This model allows increases in receipts from house sales to be shared between social housing providers, at an affordable price, without exacerbating all of the problems created by a 100 per cent ownership model. This approach only becomes more viable in places where land values are already lower.

- **TRANSACTIONAL AND TRANSFORMATIONAL EXCHANGE**
  Housing associations have expert knowledge about the diversity of tenure arrangements and sales models, bringing strong commercial acumen to the venture. They also have greater experience in identifying market needs and wants, having competed with other providers.

"This kind of evaluation just isn't there in local government" CABINET MEMBER FOR HOUSING, CITY COUNCIL

Local authorities often have land, a steady supply of tenants, existing stock, and borrowing potential at a much cheaper rate than much other institutional funding.

CHALLENGES REMAINING

This agenda is not without its challenges – most of them political. There is some hesitation about adopting these strategies, due to concern that they could be later abandoned following a change in in local leadership, or that they may be unpalatable dependent on changes within political parties.

Further, this approach is not suitable for every place. In Manchester, for instance, 30 housing associations and all ten councils are currently debating a 'memorandum of understanding' (MOU) which will set targets across the region for housing. The MOU will create shared goals on employment, crime and disorder, and health. However, the combined authority is also using this memorandum to set structured targets for housing associations to sell properties through the Right to Buy. They believe that house prices are low enough within the city region for ownership to become a universal objective.

Unsurprisingly, opinions on this are split. While this agenda is combined with a strong skills programme and could therefore be seen as citizen empowerment, it may equally be seen as short-termist given that affordable housing is already in high demand and house price inflation is likely to outpace wage increases associated with growth ambitions in the region.

"Part of me feels like this is about playing to the centre – playing to power to get more of it yourself" DIRECTOR OF INVESTMENT, HOUSING ASSOCIATION

Finally, there is concern that prudential borrowing powers will be withdrawn. Prudential borrowing was introduced in 2003, allowing local authorities to borrow to invest in capital works and assets, so long as the cost of that borrowing was 'affordable' as set out by a professional Prudential Code, endorsed by the Chartered Institute of Public Finance and Accountancy.[12] By 2007 £6.13 billion had been borrowed through this mechanism[13], with 74 per cent of London Boroughs, 82 per cent of Unitaries, 94 per cent of Counties, and 97% of Metropolitan Districts using prudential borrowing. While the last systematic review was in 2007, it is inevitable that following five years of austerity, these trends will have continued. There is in turn fear in the sector that prudential borrowing capacity will be cracked down upon, hindering these kinds of housing strategies.

'What is needed is a positive frame of mind… in the public sector we are often guilty of hesitation. We need more off the wall ideas' DEVELOPMENT DIRECTOR, HOUSING ASSOCIATION

12 CIPFA (2011) The Prudential Code for Capital Finance in Local Authorities. Available at: http://www.cipfa.org/policy-and-guidance/publications/t/the-prudential-code-for-capital-finance-in-local-authorities-2011-edition-book

13 LGA (2007) Funding Innovation: Local Authority use of Prudential Borrowing. Available at: http://www.local.gov.uk/c/document_library/get_file?uuid=92c23c04-791d-4090-9a09-9aa5643d4958&groupId=10180

THE VIEW FROM NLGN

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Housing is a unique product for two reasons. First, how it is owned determines the structure of our national economy. In Britain, mortgage debt holds a greater share of GDP[14] than in any other liberal market, making growth in home ownership a top priority in Whitehall. However, the second unique characteristic of housing is that it is spatially fixed. This means that the specifics of place – reflecting a whole series of local investment decisions – affect its market value. Further, the richness and diversity of the communities who dwell within are central to determining its social value – and ultimately therefore the sustainability of the place.

For this reason, locally sensitive solutions to the housing crisis are not just logical, but imperative. Devolution is making it both more possible, and more essential to think strategically. The Brighton and Hove case demonstrates how exceptional awareness of the characteristics of a locality can be integrated into housing policy. Principally, this can be used to grow the local economy, not only through construction jobs and apprenticeships, but also by understanding the relationship between the incomes of key

14 Schwartz, H. and Seabrooke, L. (2008) Varieties of Residential Capitalism in the International Political Economy: Old Welfare States and the New Politics of Housing. Comparative European Politics, 6(3), p 237-261

parts of the workforce and the homes they want, rather than as a relationship simply between the values of different properties, values which have long outstripped wage inflation in high demand cities. In Brighton this not only meant supporting key workers, but also ensuring that the city could sustainably support the workforce who are critical to an industry which brings place distinctiveness, and ultimately makes them competitive as a city region.

Of course, this won't be appropriate for every authority. Brighton is an exceptional case with above average national land values, and a steady influx of high-skilled but low income labour. However, elsewhere this strategy still has strong appeal as a result of its capacity to be a lynchpin of shared services. After all, homes are where communities begin and if done intelligently these projects can be used as a platform for double devolution. Beyond collaboration with housing associations, local government should engage community groups and service providers to identify how new housing scheme design can best create inclusive communities which support those in need and pre-empt changing demographics, for example, by providing a real variety of options for the elderly.

In sum, the challenge for the sector remains expanding their social and institutional network in ways which build local resilience. In housing, this is particularly important as pressures can be created from not only national, but often global forces. Innovating with a range of partners in ways such as those outlined here, the sector should find solutions which are place specific. This would not only ensure that this new era of council house building is markedly different from the last, but also optimise the benefits that housing can bring to communities and place-distinctive local economies.

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