

INVESTING IN AFFORDABLE HOUSING

Consultation Paper: Social Housing Assistance –
Principles of Recovery

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Foreword

The Homes and Communities Agency funds the delivery of affordable homes through its National Affordable Housing Programme. During the 2008-11 Spending Review period we will invest over £8 billion through our baseline NAHP. Our investment in affordable housing continues to be further augmented by additional programmes such as Kickstart and Local Authority New Build. These programmes represent a major investment in affordable housing that will provide homes for those in greatest housing need and opportunities for first time buyers, key workers and others to enter the housing market.

Over time, some of these properties will leave the social housing sector – people who have bought a share in their first home will, as their incomes grow, buy larger shares until they own their own home; housing associations managing rented homes may decide, at some point in the future, to dispose of those homes to, for example, change the social mix of a community. Such changes can have a positive economic and social impact – encouraging more mobility within the social housing sector, more intermediate market opportunities for families entering the housing market, and more opportunities for social renters to be mobile – as well as generating receipts from the sale.

As these changes take place, we do not want to stand in the way of individuals buying their own homes or housing associations making sensible decisions about the management of their stock. However, we do want to ensure that the receipts from sales and disposals are re-invested in the right places, and for affordable housing that is needed, to ensure housing opportunities in the future.

In this consultation we set out some options about how funding for affordable housing is recovered and recycled in the future. We need to do this because we will soon move to delivering our funding for affordable housing under section 19 of the Housing and Regeneration Act 2008 (HRA 2008) which gives the HCA more options as to how it might provide financial assistance – through equity or loans – in addition to the current position of subsidy in the form of grant.

As we switch to using our new s19 powers, we want to start to move to a model where the HCA is clearly seen as an investor in affordable housing sharing risk with providers but also benefitting when values rise.

This consultation document sets out some options for what would be our standard approach to recycling and/or recovery (which would form the basis of a new General Determination on Recovery) and invites your comments. We also set out the ways and timetable in which any changes could be effected and invite your detailed comments on what would work most effectively for all stakeholders.

Context

Current Position

When a housing association (HA) sells a property, the receipt from the sale is available to that HA to be reinvested into housing and related activities. Many housing association properties were originally provided with a financial subsidy from Government, paid through the HCA, the Housing Corporation or a local authority, in the form of grant. When these properties are sold, rather than having to return the grant to the HCA, the housing association can reinvest it in line with national and regional housing priorities.

The use of these recycled resources is subject to controls:

- Housing associations are legally required to maintain a Disposal Proceeds Fund (DPF) for net receipts from the Right to Acquire and Social HomeBuy disposals sales. The DPF is used to provide replacement social rented housing, with some limited flexibility for receipts from Social HomeBuy sales. The Tenants Services Authority has policy responsibility for the procedures relating to the crediting and use of DPF and details of current policy with respect to the DPF are available on the TSA website. The DPF is not covered by this HCA consultation.
- In the case of other disposals, recycled grant is placed in a Recycled Capital Grant Fund (RCGF) and reinvested only on works that would qualify in principle for Social Housing Grant (SHG) provided by the HCA through the National Affordable Housing Programme (NAHP), as well as to fund flexible tenure for shared owners. If the money is not reinvested within three years it is returned to the HCA. Full details of the requirements and processes that apply to the RCGF are set out in the Affordable Housing Capital Funding Guide (CFG) which is available through the HCA website.

At present, the maximum amount recycled into the RCGF is no more than the monetary amount of grant originally given. For example, if a Newbuild Homebuy (NBHB) property is built with a HCA grant of £30,000 and its initial sales value is £100,000 with a 50% share sold then, even if the owner staircases to 100% ownership after ten years with a new valuation of £200,000 (generating a £100,000 receipt), the amount credited to the RCGF will still be the initial grant amount of £30,000.

The current situation is different for other providers of affordable housing including private sector providers, Arms Length Management Organisations (ALMOs) and – in the future – local authorities. For these organisations, the HCA's Grant Agreement requires that there is repayment to the HCA in the event of disposal and that the amount returned to the HCA is linked to the uplift (or fall) in the value of the property at sale.

Previous Proposals for Change

In 2006, the National Audit Office report into low cost home ownership, '*A Foot on the Ladder: Low Cost Home Ownership Assistance*' (July 2006) and the report of the Shared Equity Task Force (December 2006) recommended that the then Housing Corporation work with government and associations to ensure that equity growth in

grant funded properties is captured and recycled, by considering linking the amount recycled to the growth in value of the property. The NAO considered that this would maintain the value of taxpayers' funds in real terms.

Both reports set out strong arguments for the position that the amount of grant to be recycled should be calculated in a way that takes account of the growth (or fall) in the property's value after Government (on behalf of the taxpayer) has first invested in it. If subsidy pays for 30% of the property when it is originally provided, then the amount recovered and recycled should be based on 30% of the new value. So, in the example used above, the amount recycled would be higher than the £30,000 initial grant to reflect the uplift in value.

Following these reports, the Housing Corporation consulted in early 2007 on proposals to link the recovery (or recycling) of social housing grant (SHG) to uplifts in value.

- Following that consultation, it was agreed to proceed with such a link, but as outlined in the 2008/11 National Affordable Housing Prospectus to: apply it only where SHG funding exceeded 25% of the total capital costs of a Newbuild HomeBuy scheme; but
- to suspend its implementation pending the outcome of the initial bids round for the 2008/11 NAHP where we sought to exceed agreed efficiency targets and improve affordability; and
- apply it for homes purchased in future using a government funded equity loan.

Given the outcome of the initial bids round, and the exceptional value for money which was achieved, the Housing Corporation's Board took a decision that the implementation of a link to value would remain suspended as outlined in the Housing Corporation's April 2008 Guidance on Regular Market Engagement.

Market Changes

During the course of 2008 and 2009, significant and continuing changes in market conditions have led to pressures on the delivery of affordable housing. These pressures include reductions in the volume of s106 schemes, reductions in cross-subsidy from Low Cost Home Ownership (LCHO) and properties for sale, and a tightening of available credit and increased borrowing costs.

As a result of these changes there has been upward pressure on grant rates for affordable housing. The HCA has shown increased flexibility, within its existing competitive framework, to respond to these pressures including engaging in tailored conversations with individual providers.

In the light of these changes, and the substantial impact that they have had on the value for money framework for affordable housing, we think that it is right to look again at the issue of recovery. In particular, we want to consider how the HCA's significant investment in affordable housing at this point in the market cycle can be made in a way which enables the HCA to recover investment as values start to rise.

Following the establishment of the HCA, we wrote to investment partners in early December 2008, signalling our wish to move to making funding available as an investment. The move to the use of our new section 19 powers for the provision of

Social Housing Assistance gives us the opportunity to consider how this can be done most effectively.

Introduction of Section 19 Powers

The HCA's Funding Flexibility

The change in the powers that the HCA can use to fund affordable housing – the 'switching on' of our new section 19 powers of the Housing and Regeneration Act 2008 to replace the 'saved' powers currently used to fund affordable housing – is a very significant one.

The new Act specifically states that "Financial assistance may be given by way of grants, loans, guarantee or indemnity, investment or incurring expenditure for the benefit of the person assisted."

This is considerably more flexible than the current approach where subsidy under the National Affordable Housing Programme is given in the form of Social Housing Grant.

We welcome this flexibility – which was one of the core elements of the business case for the creation of the Homes and Communities Agency – and we look forward to working with providers and Investment Partners on specific schemes to determine which mix of funding works best for both parties.

This new flexibility gives us more options for our funding so that, for example:

- The mix of equity, loan and gap funding being used in our Kickstart scheme could be used to fund affordable housing development;
- We could agree bespoke packages with providers, funding, for example, the London and Quadrant UpToYou model with a mix of grant and equity funding;
- We could take an equity stake in the affordable housing element of a development and roll this stake forward into subsequent phases of the development.

The use of these new powers will increase the flexibility of our funding offer and, based on feedback from our Partners since the Agency was established, we expect this flexibility to be welcomed. We expect to use this flexibility extensively following the 'switching on' of these new section 19 powers.

For the majority of schemes, we will follow a "standard" approach to investing for the purposes of providing affordable housing. This consultation paper outlines options for our standard approach to the recovery or recycling of social housing assistance. Where we depart from our standard funding rules we will agree a contractual framework with an individual provider that covers the needs of a particular scheme or project.

Options for Change

Options for Recovery and Recycling

In setting out on this new way of working we therefore need to set out clearly our standard or default option for how subsidy from the HCA will be recovered and recycled. This default option will not operate on every scheme – some will have a different contractual framework – but the default option will form the basis of a new General Determination on Recovery.

The General Determination will not apply to schemes that we fund through providers not registered with the TSA – where different contractual arrangements will apply – or to schemes and projects with a Registered Provider where a bespoke contractual arrangement has been agreed.

There are three options which could form the basis of a new General Determination on Recovery, which would be our default approach on recovery (and/or recycling) of Social Housing Assistance.

Option 1

We retain the system of recovery and recycling which currently operates for the housing association sector through the current General Determination (The Recovery of Capital Grants and Recycled Capital Grant Fund General Determination 2006) and for other providers through our contractual agreements with them.

This option recognises that housing associations do not distribute surpluses and that receipts are recycled – through the RCGF or in other ways – to pursue housing and related objectives, for the benefit of the communities and to reinvest in new supply. Consideration of this option will need to include testing whether the allowable uses of RCGF continue to be appropriate, and consideration of the timescale for recycling and the wider control framework for RCGF.

It is important, however, to recognise that this is not a no change option. The introduction of our new section 19 powers will confirm our power to invest as equity or loan and we would still expect to make early and significant use of these powers through bespoke contracts on projects where this was agreed to be appropriate.

For Registered Providers who do not have a RCGF – that is, providers who are not housing associations – we would continue to apply the current contractual arrangements (which are based on option 3 below.)

Option 2

A second option is to return to the proposal made as part of the last review of RCGF and link recycling to uplifts (or falls) in value

This would respond to the recommendations of the National Audit Office that we should ensure that equity growth in grant funded properties is captured and recycled, by considering linking the amount recycled to the growth in value of the property. In

2006 the NAO considered that this would maintain the value of taxpayers' funds in real terms.

Under this option, the amount to be recycled by housing associations would increase (if there was an uplift in value). The means by which recycling takes place for associations – through RCGF – would not change. Consideration of this option will need to include testing whether the allowable uses of RCGF continue to be appropriate, and consideration of the timescale for recycling and the wider control framework for RCGF.

For Registered Providers who do not have a RCGF – that is, providers who are not housing associations – we would continue to apply the current contractual arrangements (which are based on option 3 below.)

Option 3

The final option would be to link recovery to uplifts (or falls) in value and for funding to be recovered directly by the HCA rather than recycled by the provider within its RCGF.

This is the approach that is currently taken for all providers who are not housing associations regulated by the TSA – including ALMOs, private sector providers and, from this year, local authorities.

Recovery direct to the HCA would help the Agency's budget position in future years following a period where it has needed to invest substantial sums of public money to keep supply moving.

In the next section we set out the basis of our preferred option:

- option 1 for social rent properties; and
- option 3 for homes for low cost home ownership and intermediate rent.

Assessment of options

We have undertaken some internal consideration of these options and each has advantages and disadvantages. Before reaching a final conclusion we would welcome views on which of these options should be set as the 'default option' within a new General Determination on Recovery.

We would particularly value comments on the following set of issues:

1. **Homes for low cost (social) rental** – our initial thinking is that we do not propose to change the current recycling arrangements which apply to social rented homes. The current system appears to encourage good practice in housing management and a proactive approach to stock rationalisation. Further, we think that introducing a different system for social rented homes – most of which stay in the sector for long periods of time and where value uplift is unlikely to be significant – risks creating bureaucratic complexity without substantial benefit. Therefore – for social rented homes – arrangements would remain as now for housing associations (option 1). We would welcome comments on this approach.
2. **Homes for intermediate rent and low cost home ownership** – there is a significantly stronger case for moving to link to value for intermediate rent and low cost homes ownership homes. This was a core recommendation of the NAO and the Shared Equity Taskforce in their respective reports on low cost home ownership. A previous review of the position concluded that there should be a link to value but implementation of this change was suspended given the value to Government of extremely low subsidy rates for LCHO. The changes forced by current market conditions mean that the case should be reconsidered; particularly considering whether option 2 or 3 should become the default option for these products.

In addition, the Agency is keen to move to an investment based approach to providing social housing assistance, to encourage efficiencies in the amount of investment being requested and to move to a model where we share risk with our investment partners – benefiting from equity uplift where it occurs, and taking a proportionate share of the impact where values fall.

In reconsidering the case for introducing a link to value for intermediate rent and LCHO products we would welcome views on the following specific points:

Impact

We recognise that this is a significant change and one that will have consequences for associations in terms of their business planning and their approaches to bidding for support from the HCA. We will be working with the TSA, the NHF and others during the consultation period and we would welcome responses to this consultation which will help us quantify the effect of the proposed changes on associations.

We have set out alternative approaches where grant is recycled within an Association's RCGF (option 2) or recovered directly by the Agency (option 3). Option 2 has some advantages in that recycling can happen quickly and current rules mean that it needs to be focused on new supply. Option 3 – our preferred approach – would create a more transparent system across all providers and would allow the Agency to use recovered funding on its key priorities. We would welcome views on these two alternatives. In particular, we wish to understand if there are additional consequences for organisation's business plans of moving to option 3.

Calculating Uplift – LCHO sales

There are different ways in which a link to value can be calculated. We would propose to recycle or recover assistance plus uplift in value;

- in relation to low cost home ownership sales where the initial sale proportion exceeds that anticipated at the point at which social housing assistance was awarded; and/or
- where the initial sales value exceeds that anticipated at the point at which social housing assistance was awarded; and
- the same principles would apply when calculating uplifts at staircasing events

In annex 1 we show how this would work in a number of scenarios.

We would welcome feedback on whether this is the appropriate way of calculating a link to value or whether an alternative approach - using total scheme costs of a property as a proxy for initial value – would be more transparent.

Intermediate Rent

We do not wish to prevent the sale of properties to individual purchasers in need of assistance where it is appropriate to do so – for example where the purchaser has been living in the property on intermediate rented terms and is now in a position to purchase, and moving to an alternative property simply because it is available for purchase is both disruptive and more costly for the individual. Do any of the options create any disincentives – to individuals or providers – for such movement?

Outright Sale

In the case of properties for outright sale, financial assistance will be recovered plus a share of uplift calculated on the amount by which the actual sales value exceeds projected sales value at the point at which assistance was awarded. Where such financial assistance is awarded, recovery arrangements will be specified through a contractual agreement for individual schemes or groups of schemes.

Timetable

We want to be clear that any changes will only apply prospectively from the agreed date of implementation. Schemes which have already received allocations at the date of implementation will not be affected.

A General Determination on Recovery therefore needs to be in place by 1 April 2010. This is the date that the TSA are currently working to in establishing their new powers of registration under the Housing and Regeneration Act 2008 and when the HCA's new section 19 powers in respect of social housing assistance will be 'switched on'. However, given the timing of this consultation, we expect that the current arrangements will apply on that date.

Following consultation, and agreement of any proposals for change, we will revise the General Determination.

We would welcome views on the timetable for implementation of any changes.

Key Questions and Next Steps

We outline below some of the key questions raised in the consultation paper. Stakeholders should not be constrained by these questions. You may choose not to answer all of them and the HCA is open to any other thoughts or views about the proposals in the consultation document.

Question 1: Which of the three options should be the standard or default option for recycling / recovery?

Question 2: Do you accept the case for operating different regimes for social rented homes and low cost home ownership?

Question 3: What would be the consequences for RSL's business plans of moving to option 2 or option 3 for LCHO?

Question 4: How might options 2 and 3 impact upon RSL's asset management strategies?

Question 5: What is the most appropriate way of calculating a link to value? Would an alternative approach – e.g. using total scheme costs of a property as a proxy for initial value – be more transparent?

Question 6: Do any of the options create any disincentives – to individuals or providers – for movement from intermediate rent to sale?

Question 7: What are your views about the timetable for making any changes?

Question 8: Do you have any further comments that you would like to make on these proposals?

Responses should be made by 15 March 2010 and can be sent in writing or by email to Peter Jones at the address below, or completed online. [Click here for the online consultation.](#)

Responses and comments should be sent to:
Peter Jones, Head of Investment (Regional Partnerships)
Homes and Communities Agency
149 Tottenham Court Road
London W1T 7BN
peter.jones@hca.gsx.gov.uk
By 15 March 2010

Consultation Process

This is a statutory consultation under section 34 of the Housing and Regeneration Act 2008 (HRA) and is concerned with the proposed events and principles under sections 32 and 33 of that Act and under which the Agency may recover social housing assistance given under section 19 of the HRA.

This consultation is directed at all recipients of social housing assistance. In particular, for the purposes of section 34(4) of the HRA the HCA is consulting such bodies appearing to it to represent the interests of social landlords.

The timetable for consultation and implementation is:

Launch of consultation process 14 December 2009

Formal consultation ends 15 March 2010

Proposals for change will need to be agreed by the HCA Board and by the Minister. Through the consultation process we are seeking views about an appropriate implementation date.

Annex 1 – Example Recovery Calculations

Example 1

Initial sale and staircasing in a rising market (assuming 5% increase in value each year)

| | Initial sale | Staircasing after five years |
|---|---------------------|-------------------------------------|
| HCA investment in unit | £21,107 | |
| Estimated value of property at completion | £122,000 | |
| Expected first tranche sale | 40% | |
| Expected amount of unsold equity following first tranche sale | 60% | |
| Investment as a proportion of estimated value of unsold equity | 28.8% | |
| | | |
| Value of property at first tranche sale | £122,000 | £155,706 |
| Proportion of equity purchased | 50% | 10% |
| Value of sale | £61,000 | £15,571 |
| Additional equity purchased | 10% | 10% |
| Investment to be repaid (investment x additional equity % as a proportion of expected unsold equity at first tranche sale) | £3,518 | £3,518 |
| | | |
| Equity uplift | £0 | £33,706 |
| Value of equity uplift to be recovered | £0 | £972 |
| | | |
| Total amount to be recovered to the HCA | £3,518 | £4,490 |
| Amount that would be recycled under current arrangements | £3,518 | £3,518 |

Example 2

Initial sale and staircasing in a reducing market (house prices drop 2% a year)

| | Initial sale | Staircasing after five years |
|---|---------------------|-------------------------------------|
| HCA investment in unit | £21,107 | |
| Estimated value of property at completion | £122,000 | |
| Expected first tranche sale | 40% | |
| Expected amount of unsold equity following first tranche sale | 60% | |
| Investment as a proportion of estimated value of unsold equity | 28.8% | |
| | | |
| Value of property at first tranche sale | £122,000 | £110,278 |
| Proportion of equity purchased | 50% | 10% |
| Value of sale | £61,000 | £11,028 |
| Additional equity purchased | 10% | 10% |
| Investment to be repaid (investment x additional equity % as a proportion of expected unsold equity at first tranche sale) | £3,518 | £3,518 |
| | | |
| Equity uplift | £0 | -£11,722 |
| Value of equity uplift to be recovered | £0 | -£338 |
| | | |
| Total amount to be recovered to the HCA | £3,518 | £3,180 |
| Amount that would be recycled under current arrangements | £3,518 | £3,518 |

Example 3

Initial sale at predicted level of equity % and then staircase to 100% after ten years (house prices rising by 5% a year)

| | Initial sale | Staircasing out after ten years |
|---|---------------------|--|
| HCA investment in unit | £21,107 | |
| Estimated value of property at completion | £122,000 | |
| Expected first tranche sale | 40% | |
| Expected amount of unsold equity following first tranche sale | 60% | |
| Investment as a proportion of estimated value of unsold equity | 28.8% | |
| | | |
| Value of property at first tranche sale | £122,000 | £198,725 |
| Proportion of equity purchased | 40% | 60% |
| Value of sale | £48,800 | £119,235 |
| Additional equity purchased | 0% | 60% |
| Investment to be repaid (investment x additional equity % as a proportion of expected unsold equity at first tranche sale) | £0 | £21,107 |
| | | |
| Equity uplift | £0 | £76,725 |
| Value of equity uplift to be recovered | £0 | £13,258 |
| | | |
| Total amount to be recovered to the HCA | £0 | £34,365 |
| Amount that would be recycled under current arrangements | £0 | £21,107 |