Government and Public Sector

Hard times, new choices

A new deal for housing associations

L&Q

PricewaterhouseCoopers

During summer 2010 PricewaterhouseCoopers LLP (PwC) and L&Q worked with a small group of experts in affordable housing finance, law, development and management to consider how housing associations could best respond to a new age of austerity in public expenditure.

This paper is intended to provoke new thinking and debate about how housing associations should operate. It is a call to action to the sector itself and offers government fresh ideas on how affordable and social housing might be funded and regulated.

The paper was developed by the following contributors, although it has also had some exposure to and comments from a wider audience:

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Introduction

What should Government do? How should it do it? The new Government has laid down the challenge on budget deficit reduction across the public sphere. There are fundamental questions about the role and reach of the state and a Big Society of non-state providers and volunteers. Every sector must respond.

This paper examines what housing associations could do differently in a new age of austerity to help deliver the large numbers of affordable homes we continue to need in this country. There is not enough new housing and too many households are excluded from housing of their choice.

Last year only 118,000 new homes were built in England, the lowest total since the Second World War.[1] Nearly 1.8 million households were on housing waiting lists.[2] Lower quartile house prices are six times median annual earnings.[3] Mortgage lending in 2009 was half that of 2007[4] and most first time buyers required a deposit of 20-25% to obtain a mortgage at an affordable interest rate.

There are major economic and social risks in failing to meet our housing needs effectively. Risks to growth, risks to social cohesion, risks to perceptions of a fair society and therefore risks to the prospects of a 'social return' from a Big Society agenda.

Across the affordable housing sector innovative ways have to be found to maintain housing supply and to open new sources of housing funding. While public funding will remain important to delivering homes for lower income households in need, affordable housing providers and managers cannot rely on government to the extent they have in the past.

Housing associations must become smarter in their use of assets, more efficient in their use of resources, and more creative in seeking solutions to housing and community needs.

This paper calls for a new contract between government and those housing associations willing to work their resources harder. Housing associations can do more for less, in return for government providing greater operational freedoms and helping to maintain certainty of income streams and programme levels and credible regulation. With the right terms and conditions, all housing associations should be able to sign up to the new contract.

The paper also poses a number of questions around key, potentially controversial, issues where the group did not reach conclusions, but where resolution is important to ensure effective, accountable provision and management of affordable housing in the new financial environment. For example, what is the appropriate response if some associations feel unable to agree the new contract? How are residents properly empowered and boards held accountable in a higher risk environment? These questions are set out on pages 16 and 17.

We want to trigger debate within the sector, with government and with other stakeholders. We recognise some of our suggestions touch on complex issues. We aim to create a basis for dialogue and, hopefully, consensus.

1 CLG Housing Statistics 2010
2 CLG Housing Statistics 2010
3 Land Registry and Annual Survey of Hours and Earnings data, 2009
4 Bank of England Inflation Report, May 2010

Summary – how housing associations can do more

- Meeting the increasing need for housing as our population grows and government funding reduces requires radical new thinking. Far more money will have to be generated from other sources. As non-state, third sector providers, with sizeable assets, housing associations can make a strong contribution. (p.7)

- A more challenging economic and political environment will require housing associations to be more autonomous in the future. This will involve improving their financial strength, generating a surplus on their core business and using that surplus to meet more housing and community needs. (p.7)

- Where housing associations are willing to contract to generate extra financial capacity, with the attendant risks and higher gearing that entails, and to work using lower housing grant rates and public equity funding, the Government should in return contract to offer programme certainty for 3-4 years, greater availability of discounted publicly held land for development, a degree of rent and asset management flexibility, a benefits system which supports associations' creditworthiness, and a conducive regulatory environment. (p.8)

- With the right freedoms and flexibilities, housing associations should be able to sign up to a new contract with government, responding as appropriate to their particular circumstances. However, given the public finance position, it is legitimate to consider what a different contract for any who felt unable to participate might look like. (p.9)

- Increasing the number of pathways to home ownership will allow associations to do much more. Using a proportion of housing association voids for intermediate market sales or rent, and possibly market sales, would generate significant extra financial capacity to increase total affordable housing supply at lower public grant levels. It could also bring wider social benefits, including creating more income balanced, multi-tenure communities. (p.10)

- A more flexible rent regime could deliver big economic and social benefits in housing, including producing large amounts of new financial capacity, reducing carbon emissions in existing homes, and helping drive housing management efficiency and quality. Using tenure incentives and providing homes for more lower paid working families could help encourage work and tenure mobility. (p.11)

- Rent to buy options are needed and could be used to bridge the demand gap created by ongoing restrictions in mortgage credit. A new form of time-limited intermediate housing tenancy, aimed at lower paid working families on housing waiting lists, could encourage social mobility, encourage employment and produce considerable additional borrowing capacity for housing associations to build more affordable homes. This additional form of tenure would not impact on security of tenure within standard social rented housing. (p.12)

- A radical simplification of the welfare benefits system is planned, but in pursuing a more coherent and logical system the Government should recognise the potential implications of Housing Benefit reform on housing association business plans and on future affordable housing supply. Any single benefit solution should avoid undermining investor confidence in housing associations. Lack of income certainty would produce a profound change in the risk profile of the sector, quickly eliminating many of its third sector advantages. (p.12)

- Housing associations gain strength and financial leverage from regulation that is independent, credible and effective. Independent regulation has given lenders the confidence to invest large sums of money at differentiated rates which allow associations to deliver on their, and government's, social and economic objectives. As housing associations take on additional risk, credible, effective regulation has to be maintained to continue supporting strong lending, to push improvements in housing management quality and organisational efficiency, and to support resident empowerment and localism. (p.14)

The affordable housing marketplace

The Government wishes to see more homes built, to protect the most vulnerable from the effects of cuts, and to promote home ownership and aspiration. As government spending reduces, radical new thinking is needed to meet these goals.

Housing supply across all tenures has fallen dramatically short of the country's needs as the population has grown, leading to rapid house price growth and severe rationing of social rented housing. The collapse in mortgage credit and house building through the recession has only served to exacerbate these problems.

The average deposit required by lenders from first time buyers is now over £30,000 nationally and £50-60,000 in London, ie. higher than average gross annual earnings.[5] Around 80% of first time buyers now require financial help to raise a deposit, mostly from relatives. The average age of an 'unassisted' first time buyer rose from 33 to 37 in the two years to 2009.[6]

More and more people are unable to afford the open markets for sale or rent, but have little or no priority for limited social rented lettings. In different parts of the country the intermediate market now encompasses a huge swathe of the working population and a wide range of incomes. Low income, working families earning around £12,000-£25,000 find their housing choices particularly constrained.

At present there are three main providers of new homes – private housebuilders, housing associations and, just beginning to play a role again, local authorities and Arms Length Management Organisations (ALMOs). Our mixed economy in affordable housing development involves all three types of organisation. But building affordable homes currently relies on government funding, irrespective of the builder.

The vast majority of new affordable homes in the last 20 years have been built through a combination of government grant, section 106 contributions, private borrowing by housing associations and the use of housing association surpluses. The encouragement of private housebuilders into the funding system has increased the number and choice of suppliers, but has not produced a major increase in affordable housing supply as only a small number of housebuilders see it as core business.

More new affordable homes can only be provided if the money is there to build them. With government finances badly depleted, that money will have to be generated from other sources.

Housing grant will fall as the new Government tackles the public deficit. The challenge for housing associations and others in a mixed development economy is not just to compensate for that fall, however extensive it proves, but to consider how best supply increases can be maintained across tenures.

Yet all housing providers have been severely hampered by another challenge since 2007 – market conditions. Government has been instrumental in pump-priming what limited new development there has been in the past two years. In 2009/10, public funding supported 74% of the 87,000 total housing starts in England, according to the Homes and Communities Agency.[7]

Innovative ways must now be found to do far more with less government support. More new affordable homes can only be provided if the money is there to build them. With government finances badly depleted, more of that money will have to be generated from other sources.

5 Meeting the Challenge, Housing Finance Group, March 2010; Hometrack data, 2010
6 Council of Mortgage Lenders, 2009
7 CLG Housing Statistics 2010 and Housing Outputs 2009/10 Homes and Communities Agency (see Inside Housing 18/6/10)

Defining the new housing association contract

Private finance and stock transfer have transformed the housing landscape in the last 20 years. Since 1988 housing associations have raised £60 billion in private finance and invested £16 billion of their reserves in new housing supply.[8] Added to government grant funding of £40 billion, this £76 billion of non-state finance has delivered two million new and improved homes; arguably the most successful public private partnership on record.

But the game has now changed unequivocably. The Government is asking how activity can be provided more effectively, at lower cost, and to produce greater economic value.

This demands a new spirit of social enterprise from the housing association sector. Associations with potential capacity must find the mechanisms to release it. Those with assets and relatively low liabilities should be encouraged to embrace the public good and commit to making the most of those assets.

> *The game has changed unequivocably. Those associations with assets and relatively low liabilities should get involved, embrace the public good and commit to making the most of those assets.*

There is more potential to be realised from housing associations. They have competitive advantages in the marketplace that can be exploited more rigorously:

- Third sector flexibility enables associations to operate across the market, delivering social rented homes, shared ownership and shared equity, intermediate rent and market sale, with the opportunity to scale up or down in each market as required by economic and social conditions
- They have a large housing asset base to draw on
- Their borrowing does not count against public sector net debt

> *Housing associations have competitive advantages in the marketplace. Their status as third sector, non-state providers is key.*

- They are the acknowledged experts in the intermediate market – a rapidly growing marketplace – and cross-subsidies can make a valuable contribution to new social rented development
- Independent regulation and mixed funding sources have helped deliver strong lender confidence in the sector's stability
- As not-for-profit social businesses, all surpluses are reinvested into new homes, improving existing stock and improving customer services – a valuable social mission that also supports job creation and efficient use of stock
- Associations act as important agents of economic change in communities – they invest approaching £450 million a year in neighbourhood projects throughout the country, including employment, education and skills programmes.[9] Through new building, regeneration and neighbourhood initiatives they are long-term investors in the Big Society.

The third sector ethos and status of housing associations as non-state providers is key. Housing associations are there to provide housing and other economic opportunities to people in (broadly) the lower part of the income scale, and to maximise opportunities by adopting sound commercial business practices. Operational flexibility is vital to delivering those opportunities.

This is a very strong base from which to work. The question is how best to unlock additional financial, economic and social value.

8 Meeting the Challenge, Housing Finance Group, March 2010
9 Neighbourhood Audit, National Housing Federation, 2008

How the affordable housing marketplace could evolve

A mixed economy in affordable housing development will continue. We need to combine the skills and qualities of government, housing associations, private housebuilders, local authorities and ALMOs to meet the housing supply and funding challenge effectively. Each of those partners needs to take a cold, hard look at what more they can do.

Private housebuilders have unparalleled skill in land acquisition, site assembly, construction and delivering homes for market sale. They play an important role in creating more affordable housing through planning obligations. They will continue to play a role in the mixed development economy, focusing mostly on higher end shared equity products.

But they are not asset holders or managers and their primary function will remain market-led housing activity. In addition a number have suffered in the housing market crash and it may take several years for balance sheets to recover sufficiently for confidence to return to the sector.

Reform of the Housing Revenue Account could enable local authorities to deliver additional new affordable supply and make an increasing contribution to the mixed economy for affordable housing development.

Local authorities will also play a vital strategic role in planning and incentivising development, making land available, bringing local people into the house building debate and encouraging the formation and success of Local Housing Trusts.

While the housing recession has been difficult for housing associations, they continue to be in a strong position to raise finance. The credit ratings of many of the larger developing associations are actually better than those of some sovereign European nations at present. In 2009/10 there were nearly 47,500 affordable housing starts, the vast majority of them by housing associations.[10]

Housing associations are in a particularly strong position to help lower income working families currently caught in housing market no-man's land.

Evolving the housing association contract with government

If Government wishes to make the most of this strong starting position, it needs to work with those housing associations willing and able to develop, accept more risk, become more efficient and work their assets harder. These associations should be offered a new contractual framework by government. The Government is in a position to:

- offer programme certainty for the coming 3-4 years
- encourage the use of and deliver public land on terms which make new affordable development viable
- offer greater operational freedoms around asset management
- create a degree of rent flexibility
- ensure any reform of welfare benefits does not undermine lender confidence in, or terms for, the sector
- ensure the regulatory environment is conducive.

This would enable housing associations to plan and finance their activities efficiently and effectively. In return, associations should be able to accept the lower grant rates the Government will require to fund a reasonable sized programme and accept the introduction of an element of public equity funding where government is sharing risk.

Housing associations continue to be in a strong position to raise private finance. They are in an excellent position to help lower income working families currently caught in housing market no-man's land.

10 Housing Outputs 2009/10, Homes and Communities Agency

The Homes and Communities Agency should have the freedom to use whatever public funding is available flexibly to deliver locally responsive solutions and ensure resources go further and produce as much new housing as possible. In parts of the country where cross-subsidy and capacity will be more difficult to generate, grant and/or equity would need to flex to help manage market conditions.

Housing associations have long-term expertise and a successful track record over 30 years in the intermediate housing market. Generating more capacity and value for money from the sector depends to a high degree on providing more homes for intermediate rent, shared ownership and shared equity. In producing more homes for lower paid working families, some of the additional capacity created can be used to deliver more social rented housing for the most vulnerable in society.

Shared ownership and shared equity are important products, attracting consistent high demand from modestly paid working households. But they depend on a mortgage market which is unlikely to be able to meet demand for several years while lenders repair balance sheets. Lenders estimate the 'mortgage gap' for 2011-2014 to be around £320 billion. Net lending is forecast to be £12 billion this year, compared to £108 billion in 2007.[11]

Rent to buy products can make a significant contribution to bridging the demand gap over the coming years. They can be funded through corporate housing association finance, rather than the mortgage market. As one of the few sectors currently attractive to private investors, housing associations are ideally placed to meet this need.

In the right conditions, with the right freedoms and flexibilities, housing associations should be able to sign up to a new contract with government, responding in a manner appropriate to their particular circumstances. This could, for example, open the way to many more housing associations acting as developers again in their own right. Others might choose to contribute assets in a different way. However, given the public finance position, it is legitimate and important to consider how a different contract for any who felt unable to participate might look. This is a key question, which needs wider debate.

Housing associations willing and able to develop, accept more risk, become more efficient and work their assets harder to generate capacity should be offered a new contractual framework by government.

11 Council of Mortgage Lenders, 2010

Generating more financial capacity and resources

More value could be extracted from existing housing association assets and resources, from their strong ability to borrow more, and from public sector resources, including land.

The Hills Report of 2007 advocated that affordable housing should be more closely aligned with work, employment incentives and social mobility. Housing associations can contribute powerfully to the housing, employment and welfare agendas. There are real opportunities here to encourage aspiration amongst lower earning working households, while delivering great value for money for the public purse.

Using void assets more efficiently

Research by a group of South East based housing associations indicates an average stock turnover of 6% a year. If half of those homes were relet on social rented tenancies, the other half could be used to generate additional capital and borrowing capacity through a mixture of market sales, conversion to shared ownership and conversion to intermediate market rent at 80% of market values.

Even if government housing grant were provided at half current levels, this would generate sufficient new capacity to produce substantial additional housing supply for social rent, intermediate rent and shared ownership. The shared ownership sales would also contribute to social rented development and eventually provide further recycled funding. The overall aim would be to increase the total affordable housing stock available for letting to people on housing waiting lists.

Giving priority through the scheme to working households moving from other areas could increase mobility within affordable housing and support employment, at the same time as producing extra financial capacity for associations.

Work by L&Q indicates that even at a stock turnover level of 2.5% a year, using half of its homes that become empty for intermediate rent at 65% of market rents could generate an extra £3 billion in borrowing capacity for the sector over five years. Given that local authorities own broadly similar overall levels of social rented housing to housing associations, the same flexibilities for councils could potentially double that extra capacity.

As a leverage proposal this is likely to work best in higher value property markets, where the differences between social rent values and the private markets are larger. But it offers wider social benefits too, which may increase its attractiveness in other areas. For example, it could help to break up large mono-tenure estates and create more mixed income communities, where paid work is a social norm.

Unlocking historic grant

There are significant numbers of housing associations who are not producing new homes, but who between them own thousands of properties. Much of this stock was provided using government grants and, particularly for homes built 15, 20 or more years ago, rental income now delivers significant surpluses for the associations involved.

The Tenant Services Authority has indicated that housing associations with 2,500 homes or fewer hold around 20% of the sector's financial capacity, while contributing around 3% of new development.[12] Many of these smaller, local associations are good housing managers, but may lack the opportunity or resources to raise finance and undertake new development.

On the right terms, many housing associations who may have been frozen out by the development partnering structure in recent years, or who find themselves in partnerships they do not believe to be efficient, could commit to using their assets to develop homes again, either in their own right or as part of consortia.

12 Housing Association Global Accounts 2009, Tenant Services Authority

It should be possible to create a mechanism which unlocks some of these assets to deliver more affordable housing supply. The new contract between housing associations and government should be drawn sufficiently widely to attract all associations who are willing to be involved and contribute resources.

The 'ideal' position is that all housing associations participate in the new contract to the best of their ability, according to their resources and circumstances. The trustees of charitable housing associations have a duty to fulfil the charitable objectives of the association. Using free assets is one way of demonstrating that associations are fulfilling their social objectives effectively and appropriately.

The financial environment and the housing supply crisis is such that it is no longer appropriate for housing associations to simply hold government grant indefinitely without making it work for the greater good. There is an increasing need for this grant to be recycled. If some associations are unable or unwilling to do this, different arrangements with government should be considered.

Better use of public land

Publicly held land, especially local authority land, HCA land and that owned by regional development agencies, is another important source of investment to keep housing supply moving while public spending is tight. The HCA's Public Land Initiative is a sound approach and should where possible be continued, linking in to plans for Local Housing Trusts.

In combination with new capacity from the housing association sector, there is an opportunity here to promote localism in development. Local authorities could invest land and take a lead in creating powerful local partnerships, special purpose vehicles and joint ventures, aligning development incentives with local social and economic objectives to ensure we produce the new affordable housing the country needs, even in a low grant environment.

Options might include providing land at discounted values, accepting deferred receipts or taking an equity stake in the development, sharing risk and reward with other partners. The cost of land is a critical aspect of development viability and local authorities are in a powerful position. Their decisions on land will determine whether many new affordable developments go ahead or not.

Through using voids differently, unlocking unused assets, rent flexibility, better use of public land and promoting tenure choice, housing associations can generate extra financial capacity. Alongside tax threshold and welfare benefit changes this can help make work pay and encourage social and employment mobility.

Rent flexibility

Affordable housing revenue streams can also be worked harder. There are good reasons to keep social rents reasonably low. And yet, for a generation of people, low rents have not translated into a strong enough incentive for some to be willing to take lower paid jobs.

This is a complicated and sensitive area, inevitably tied in with the benefits regime, education and skills and other elements of social policy. But there are possibilities under the new Government to consider a different approach.

L&Q estimates that an extra £1 a week on its rents would be enough to reduce the housing grant needed for each new affordable home by around £10,000 through the additional borrowing capacity it could generate. £1 a week off operating costs per home could do the same. Achieving both across the whole sector could potentially generate around £4 billion in further financial capacity. If local authority HRAs were to deliver the same results, the extra capacity might double to £8 billion.

The equation will differ between associations, but the example illustrates the significant impact even relatively small gains from rent flexibility or efficiency can have on capacity.

The gap between private and social rents is now very wide in high value, high demand areas. As well as holding back associations' ability to deliver new supply, a rent gap that is too big to bridge limits the ability of people in social rented housing to move on.

There are potential employment, growth and social benefits to be gained from rent flexibility too. For example, it could be used partly to deliver reductions in carbon emissions from existing affordable housing stock. This would create jobs, knowledge and economic wealth, while helping deliver the Government's commitments on climate change.

Stock and tenure turnover, work and social mobility – a new tenancy option

One effect of the dysfunctional housing market is that social rented housing turnover has fallen – by nearly 25% in the past five years.[13] People continue to rent socially because they cannot afford to enter other markets and because market volatility makes assured tenancies feel safe.

By incentivising greater stock and tenure turnover housing associations can encourage social mobility. They can encourage employment, working with changes to the tax and benefits systems to help make work pay.

In producing more homes for lower paid working families, some of the additional capacity created can be used to deliver more social rented housing for the most vulnerable in society.

This could be achieved by creating a new form of time-limited intermediate tenancy, specifically targeted at people in lower paid work on housing waiting lists. Rents would be higher than a social housing rent but still some way below market rents. This would generate significant additional borrowing capacity.

Working with their landlord to keep management and maintenance costs down, the resident could earn a 'deposit entitlement'. At the end of, say, five years, they could use this to support a move into shared ownership or full ownership in the same home or elsewhere, to trade up to intermediate market rent in the same home or elsewhere, or as a 'grant' back to the landlord for extending the tenancy, either as is or, if need be, as a social rent. L&Q's new 'UpToYou' product reflects some of these principles. Where the deposit acts to facilitate a move into home ownership, it helps create an incentive to maintain employment.

This proposal would not affect the security of tenure enjoyed within standard social rented housing. It is intended as an additional, separate form of tenure to facilitate capacity generation, fulfil individual aspirations and meet an increasingly important gap in the market.

Maintaining certainty of income streams

While third sector social and sub-market rents will be considerably cheaper for both residents and government to meet than private renting supply solutions, avoiding additional benefit payments as a result of rent flexibility is clearly important.

By working assets harder, providing intermediate market homes for modestly paid working families and using tenure incentives to encourage work, the potential negative impact of rent flexibility on benefit payments can be offset.

More widely, though, benefit payments will remain a crucial income stream for housing associations.

13 CLG housing statistics, 2004-2009

Housing Benefit for social rented properties represents around two thirds of housing association income. In 2008/09 nearly 60% of households entering social rented housing were eligible for Housing Benefit and 51% were entirely dependent on state benefits for income.[14]

Housing associations are able to secure favourable borrowing rates because of the dependability of rental income streams and sound regulatory oversight. A radical simplification of the welfare system is planned. In pursuing a more coherent and logical system the Government should recognise the potential implications of reform on housing association business plans and on future affordable housing supply.

Housing associations can work with government to ensure any single benefit solution is delivered while maintaining affordable housing supply and without undermining investor confidence. This would either need to involve a defined housing element within the single benefit being paid directly to the landlord, or, if residents are made responsible for paying rents directly, creating an environment where all residents are able to have bank accounts and housing associations can require a direct debit mandate for rent payments to be set up. A stronger, quicker process for managing arrears and bad debts would also be important.

A lack of certainty on rental revenues would produce a profound change in the risk profile of housing associations, eliminating many of their third sector advantages overnight.

Efficiency gains

As the economic and political environment challenge housing associations to be more autonomous, further operational efficiency gains will need to be identified. As a minimum, this is likely to involve associations increasing their financial strength, generating a surplus on their core business and using it to meet more housing and community needs.

Housing association boards and management should take a global view of their role, reinforcing their social roots and the imperative to deliver a strong social return and provide what is best for their customers.

In a new and much more demanding financial climate, boards should rigorously re-examine how and where efficiency gains can be achieved within their organisations, focusing, for example, on opportunities for stock rationalisation; sharing, re-tendering or outsourcing of services; more consortium working; and opportunities for merger.

Government could help drive the pace of change by offering incentives, such as payment by results; for example by matching development funding with efficiency savings, or making rent increases dependent on the release of free assets or achieving agreed customer satisfaction levels.

Government could help drive efficiency by offering incentives, for example matching development funding with efficiency savings, or making rent increases dependent on the release of free assets or achieving agreed customer satisfaction levels.

14 Responsible choices for a fairer future, National Housing Federation, 2010

Maintaining effective regulation

Independent regulation is a crucial strength of the housing association sector. It has given lenders the confidence to invest large sums of money at rates which allow associations to deliver on their, and Government's, social and economic objectives. And it has been adaptable enough to allow a flexible operational model to thrive.

Continued lender support is imperative if housing associations are going to release more capacity, take on more debt and build more homes. Registered Provider status gives the lending industry comfort and certainty and most housing association loan agreements contain a regulation covenant. Any dilution of those covenants would increase the cost of borrowing substantially, undermining new affordable housing delivery.

Strong, independent, credible regulation is crucial to delivering the private finance housing associations will depend on as they take on more risk.

The Cave review and the introduction of the co-regulatory approach has also gone some way to cutting red tape and creating a more mature system of regulation, offering residents the protections they need without adding unreasonably to sector costs.

Independent regulation has to be maintained to continue supporting strong lending, to push improvements in housing management quality and organisational efficiency, and to support resident empowerment and localism.

Conclusion

Housing need does not respect public debt levels. Indeed, need tends to grow in economic conditions which mean public funding is in short supply.

We now face a level of public debt which is virtually without precedent, matched with housing market dysfunction across all tenures.

For affordable housing and housing associations necessity should become the mother of invention. Hard times demand new choices.

Housing associations are in a relatively privileged position at present. They combine strong creditworthiness with a flexible operational structure derived from their third sector status. What is more, they still have considerable scope through smarter use of assets and improved efficiency to up their game, even in these difficult times.

That is unusual. But it is also important.

Many private housebuilders will continue to be constrained by market conditions for several years. Local authorities will be constrained by the public finance situation. Housing associations are affected too, but not to the same degree.

The challenge to housing associations in this paper is nothing less than to change the way they think and change the way they do business.

The challenge for government is to recognise the social and economic value and potential of housing associations. It should allow associations the tools and flexibility to do a job that government is no longer in so strong a position to do itself.

Cultivating a new age of aspiration in housing in current circumstances is a challenge, but not an impossible one. Achieving it requires a new kind of contract between government and the housing association sector.

Unanswered questions

In the course of discussions, contributors to this paper identified a number of issues that will be crucial going forward if housing associations are to contribute more in the new financial environment. We pose these here as questions rather than offering definitive answers. It is important housing associations, government and other key stakeholders in housing make decisions on these questions sooner rather than later.

We recognise that some of our suggestions touch on complex issues. We have set out here to encourage and provoke debate and to create a basis for dialogue and, hopefully, consensus.

Q1 Can a new contractual framework be created between government and housing associations to drive strong volumes of new affordable housing supply even as public spending reduces?

- What are the terms which would enable the whole sector to sign up and participate?
- If some associations still preferred to stand outside the framework, in a radically changed financial environment is an element of compulsion in accessing surplus assets justified? For example, with the appropriate safeguards in place to protect business stability and residents' interests, should some or all of the following be considered:
  - giving more associations the opportunity and incentive to become HCA development partners
  - contributing assets within an established housing association development partnership
  - paying back a level of historic grant or paying interest to government on historic grant, ie. switching on powers government already has, but which are currently very rarely used
  - merger with another association with the express intention of releasing assets for development
  - separating assets from management and pooling assets in finance vehicles, while enhancing a focus on community-based management?

Q2 If the Government changes rent regulation to support more housing and tenure choice for lower income working families, how should housing associations be held accountable for the use of the additional funds to provide more homes?

- How should the use of the specific additional income created through rent flexibility be made transparent to government and residents to evidence value for money?
- Is it a problem if associations make use of the funds for wider social and neighbourhood purposes, apart from extra housing provision or other set goals, as long as agreed targets under the new contractual framework are met?
- Is it justifiable to charge residents of developing housing associations higher rents? If not, how should rent costs be equalised and made fair across the sector as a whole, while ensuring the affordable homes that are needed are delivered?
- Does a higher rent imply a higher or differential standard of service and, if so, what should that be, compared, say, to the private rented sector or the 'standard' social rented management offering?

Q3 What is the balance between housing grants, government equity, public land and rent deregulation that will deliver the maximum number of new affordable homes in an age of austerity, and the right balance between social rented homes and intermediate market homes for rent and sale?

- Is a mix of grant, equity, public land contributions and rent flexibility the best approach to maximise delivery of affordable homes in the new financial climate?
- Should government grant for new housing be restricted to funding new social rented homes only, with equity finance helping to support homes for the intermediate housing market?
- What is the appropriate wider funding role for equity finance?
- How much choice should local authorities have about whether to develop new affordable housing, how much to develop, and what types of home to develop under proposed planning reform, where there is clear evidence of high unmet housing needs in their areas?

Q4 Under a new framework which is likely to increase risk, how can housing association residents be empowered to hold their landlord to account more effectively across management services, development risk and organisational performance?

- If risk control becomes a more significant priority within housing associations, how do association boards ensure this is not at the expense of a clear focus on providing locally responsive services and satisfaction for existing residents? If regulatory reform emphasises governance and viability as the priorities for the sector, what are the effective mechanisms to deliver resident satisfaction and influence in a housing association's affairs?
- Will the existing broad and relatively complex network of housing association accountability structures deliver the transparency required to satisfy stakeholders if capital and revenue funding changes are applied?

The new settlement under the Comprehensive Spending Review will be introduced in April 2011. Addressing the points raised throughout this paper and resolving the above questions as government finalises the basis for the next National Affordable Housing Programme in the coming months is important.

We are seeking to provoke debate and the emergence of consensus so please contact us with your views on this document. Contact details for PwC and L&Q are as follows.

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