Impact of Budget 2015 on housing associations

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Property analysis: What impact will George Osborne's Budget have on housing associations? David Bowden examines the proposals and talks to David Orr, chief executive officer at the National Housing Federation (NHF), and Ian Roberts, partner in Pinsent Masons LLP. Bowden also explores research from wealth manager, Canaccord Genuity, and property valuers Savills and JLL.

What is the background to this announcement?

David Bowden (DB): In para 1.140 of the Red Book, HM Treasury says this:

'Alongside the freeze in working-age benefits, the government will reduce rents in social housing in England by 1% a year for four years, requiring housing associations and local authorities to deliver efficiency savings, making better use of the £13bn annual subsidy they receive from the taxpayer. Rents in the social sector increased by 20% over the three years from 2010-11. This will allow social landlords to play their part in reducing the welfare bill. This will mean a 12% reduction in average rents by 2020-21 compared to current forecasts.'

Could the Chancellor's call for housing associations to reduce rents by 1% per year for the next four years be challenged? If so, on what grounds?

David Orr (DO): Given the changes to working-age benefits, a cut in rents over the next four years will be a real help for some tenants, but at the same time will severely constrain the ability of housing associations to meet the shared ambition of themselves and the government to drive housing growth and new jobs. At the very least 27,000 new homes will not now be built although that figure could be much higher. The right to buy for housing association tenants further compounds this.

The housing association sector will be faced with a hit of up to £3.9bn as a result of this announcement. Housing associations are a successful public-private partnership and have created their business plans based on the current rental formula. A reduction in their rental income will damage their capacity and ability to keep building. Housing associations want to work with the government to meet its housing ambitions, but this policy will make it much harder for them to do so.

Genuine economic recovery means that families and households, as well as the government, can balance their books. It is vital that welfare reform helps people into work with a focussed support on those vulnerable people who need it most. Housing associations are committed to making work pay and moving people away from a reliance on welfare payments. A blanket freeze, which takes no account of individuals' circumstances or where they live, will remove vital safety nets that prevent families and young people from becoming homeless.

In particular, a lower benefit cap outside London will have the biggest impact on families with children. The lower cap takes no account of the cost of living in different parts of the country outside the capital and will hit families including single parents with very young children.

Was this trailed in the Conservative manifesto?

DB: It should be noted that in the Conservative Party manifesto 2015 there was no mention of any proposal to reduce rents of housing associations--be it by 1% per annum or any figure. The Conservative government does not have a mandate from the electorate to do this. As this proposal was not in their manifesto, the provisions of the Salisbury onvention do not apply. The Conservative party does not have a majority in the House of Lords. This means that these proposals in the Finance Bill 2015 could have a rocky ride when the bill reaches the upper house.

Do housing associations have a legitimate expectation that their rental income will not be reduced in this way by the actions of HM Treasury? If so, then this could mean they have legitimate grounds for challenging this by means of a judicial review if the proposals are not amended in the House of Lords.

On page 54 of the Conservative Party manifesto 2015 it said:

'We will extend the right to buy to tenants in housing associations to enable more people to buy a home of their own. It is unfair that they should miss out on a right enjoyed by tenants in local authority homes. We will fund the replacement of properties sold under the extended right to buy by requiring local authorities to manage their housing assets more efficiently, with the most expensive properties sold off and replaced as they fall vacant.'

At the moment some (but not all) housing associations participate in the Social HomeBuy scheme.

Housing associations can offer shared ownership where residents can buy a share of their home and pay rent on the rest. Tenants buying another share subsequently receive a further discount on that purchase. Tenants must initially buy at least 25% of the property. Under 'staircasing', tenants can buy more subsequently until a tenant owns 100%. Where tenants buy some or all of their home, their rent will go down as this is based on what proportion of the property is rented. Housing associations can charge rent of up to 3% per year of the value of their share in the property.

Tenants of homes developed since 1993 have the right to acquire under which a discount of between £9,000 and £16,000 on the value of a home is given depending on where the property is and the size of the share bought.

Tenants of local authorities receive a much more generous discount on the market value of their homes which qualify for the existing right to buy scheme. Tenants receive a 50% discount (35% if the property is a house rather than a flat) if they have been a public sector tenant for between three and five years. After three years, the discount goes up by 2% for every extra year (1% if the property is a house) the tenant has been a public sector tenant up to a maximum of 70%. In England, this is £103,900 in greater London or £77,900 elsewhere. Some or all of this discount must be repaid where a property is sold on within five years of receipt.

It can be seen that housing associations--especially those with estates in London--will find the discounts they are compelled to offer shoot up by up to 650%. The funding for this discount will have to come from somewhere. However, housing associations do not trade for profit. This is set out in the Housing Act 1985, s 5(1)(b) (HA 1985) and was confirmed in the leading case of *Trustees of The National Deposit Friendly Society v Skegness Urban District Council* [1959] AC 293, [1958] 2 All ER 601.

A 'fully mutual' housing association under the Housing Associations Act 1985, s 1(3) (HAA 1985) means that its members are restricted to tenants or prospective tenants and this precludes the granting or assignment of tenancies to persons other than members. On the whole, housing associations receive the bulk of their funding from the Homes and Communities Agency (HCA).

The Conservative manifesto misrepresented the actual position. Certain tenants of housing associations have always had a right to buy their own property where their landlord is a non-charitable provider or there has been a stock transfer--and a right to buy has been preserved. The conditions to be satisfied to be able to exercise this right are set out in the Housing and Regeneration Act 2008, ss 180-182 (HRA 2008).

What the Conservative party manifesto misrepresented is who would fund a discount if the HRA 2008 was changed to mirror the Housing Act 1980 and provide equivalent discounts to tenants of housing associations to those who were tenants of local authorities. If the discount is not funded at 100% there may be a case for challenge in the Lords or in court.

The Finance Bill 2015 contains nothing as introduced relating to rent reductions, amendment of the Housing Acts or anything specific about housing associations. HA 1985, Sch 7 sets out restrictions on housing associations if they wish to dispose of land that they own. It is likely that these provisions would need amending to permit housing associations to sell their housing stock for anything else other than the proper market rate.

Could the extension of right to buy be challenged?

DO: The NHF says that housing associations share and deliver on the ambitions of helping people into homeownership and building more homes, and have already helped 275,000 into ownership. Housing associations also help people who aspire to live in a good quality affordable home to rent rather than to buy.

With the support of government, housing associations could do much more. They want to help more people, including our own tenants, into homeownership but we need to work with government to find a way to do that without limiting their independence as businesses, which is crucial to achieving the shared ambition to boost housing supply.

Housing associations are private not-for-profit businesses and so forcing the sale of homes at below market value could potentially breach the European Convention on Human Rights, art 1, Protocol 1, which gives everyone the 'right to the peaceful enjoyment of one's possessions'. The NHF says they want to see the full details of the proposals before they can say whether they would support a legal challenge.

DB: Tony Stacey is chief executive of South Yorkshire Housing Association. He is also the chairman of a group of 100 housing associations. He has previously told trade publication '*Inside Housing*' when the proposals surfaced in March 2015 that he would definitely launch a legal challenge. He says that the proposals are fundamentally critical to the sector. He thinks he is duty bound to fight the proposals in any way possible. Others in the sector say they would be surprised if a legal challenge did not happen because the policy has the potential to risk the viability of the housing association finance model.

The Office for Budget Responsibility has cautioned that the proposals could add up to £60bn to the national debt of the UK because imposing these enhanced right to buy proposals on housing associations could mean that HM Treasury has to account for their assets as part of the overall public sector debt.

To what extent can the government dictate the private actions of organisations such as housing associations?

DO: Housing associations share the government's vision of homes as a foundation for getting on in life. Like the present government, it wants to see more homes built, more people working and more families with a home of their own. It also wants to help people off the merry-go-round of benefits, to ensure that hard work pays and reduces the benefit bill.

Part of the proposals includes an announcement that social housing tenants earning £30,000 or £40,000 in London will have to pay market rents. The NHF says that given the scale of the housing crisis, it is understandable that government is looking for higher earners to pay what they can afford for their housing.

Housing associations would like to work with the government to find a way to make sure tenants pay a rent that reflects their household earnings, but would encourage them to avoid more red tape or blanket approaches to dealing with housing and welfare challenges. As independent businesses, housing associations need the flexibility to set their own rents in a way that reflects:

- government spending constraints
- their own charitable status
- local housing markets, and
- people's ability to pay

Housing associations have been dependant for much of their funding from the HCA. Because of their reliance on this HCA funding, the government has been in a strong position to dictate the agenda. However, as grant funding has been withdrawn following cuts to public expenditure, associations fund most of the cost of new development from their own resources and are consequently more independent.

Could the Summer Budget affect the viability of housing associations and their ability to borrow to fund housing development?

Canaccord Genuity (CG): Housing associations can improve their efficiency in the following five ways:

- greater sense of priority and clarity on the services they provide
- innovation in the way services are delivered accompanied by a willingness to delegate or subcontract services where this makes financial sense
- efficient procurement
- willingness to share head office central functions with other housing associations, and
- a new spirit of co-operation with local authorities whatever their political makeup

The effective interest rate paid by housing associations when they borrow funds to build has fallen by 1.5% per annum from 6.25% in 2008 to 4.75% in 2014. A 1% drop in the average cost of debt reduces the annual interest bill for housing associations by £600m a year. This is the equivalent of being able to build 4,000 new homes at a cost of £150k a unit.

If there is consolidation in the sector, and costs to income ratios are reduced, then enlarged housing associations, which are run more effectively and efficiently, should not find their ability to borrow to fund further development is impaired. Cannacord Genuity wonders whether if HM Treasury set up a new group borrowing vehicle this could lead to more predictable and lower cost funding for housing associations.

Ian Roberts (IR): We are likely to see some consolidation in the sector. There are a large number of smaller housing associations, which own and manage estates with less than 1000 units. Each of these housing associations has head office costs associated with management teams, boards and administration. There is little market pressure at present for housing associations to operate efficiently. If housing associations merged then they could in theory reduce their head office costs by half. This would reduce the cost to income ratio.

The market at the moment is dominated by larger housing associations. With the pressure put on housing associations to reduce their cost to income ratio by HM Treasury, it would seem inevitable that consolidation in the sector is inevitable. HM Treasury notes that housing association rents have risen by a staggering 20% over the last three years. Against this background, a stated intention that these rents now fall by 1% per year certainly does not look unreasonable. It should be noted that a large number (but not all) of housing association tenants receive housing benefit to cover all or some of their rent.

How might this affect property valuations?

Savills & JLL: The 1% rent reductions will not come into force until April 2016. Savills & JLL (the leading valuers in the sector) are advising that portfolio valuations for accounts purposes undertaken after that time will have to take this (and the further envisaged 1% per annum cuts) into account, which will mean a fall in such valuations over the period in question. However, the impact on loan security valuations undertaken on the basis of Existing Use Value Social Housing (EUV-SH) will be tempered by the freedoms of the mortgagee and successors in title from the restrictions. The effect is that security valuations in some areas may fall slightly or remain flat over the period of rent reductions. Savills & JLL also envisage that housing associations will need to pay close attention to their operating surpluses to maintain values and may look to a number of possible cost saving areas including:

- eliminating discretionary activities
- reducing development programmes, and
- cutting their operating costs

How does this fit in with the prospect planning reforms?

DO: The NHF is considering what will be the effect of reforms to the planning system that the government is separately proposing. It wants to hear more about these proposed planning reforms. There is scope to speed up the planning process and it would also welcome any steps to encourage local authorities to get a local plan in place. This is a crucial way of setting clear targets for affordable housing that truly meets local need. Any changes made should help in building good quality homes and make it easier for the full range of housing needs to be met.

The government has talked about a 'Northern Powerhouse'. This is meant to involve more powers being devolved to Greater Manchester including a land commission. The NHF welcomes the chance to work with this proposed Greater Manchester land commission so it can build desperately needed new homes for sale, rent and shared ownership. It believes devolution offers real opportunities to tackle the housing crisis that plays out differently across the country. As housing is one of the key factors that make places work, it is important that housing and planning powers feature in devolution deals.

Housing associations are already working closely with areas earmarked for devolution in future and are keen to develop their role in driving economic growth, providing programmes to help people into work and training, and delivering health and social care services.

To what extent might the Summer Budget affect housing associations and charitable organisations ability to meet their charitable objectives?

DO: Under HAA 1985, s 2, a housing trust is a body or corporation that is required by the terms of its constitution to use the entirety of its funds, including any surplus, for the purpose of providing housing accommodation, or to use the whole (or substantially the whole) of its funds for charitable purposes and it uses these funds for the provision of housing accommodation. Trusts that are registered with the Charity Commission are called charitable housing trusts.

A considerable number of housing associations are registered charities under the Housing Act 1996, s 58.

The Charities Act 2011, Pt 7 (CA 2011) prevents charitable trusts from disposing of their assets at below market value. If the enhanced right-to-buy proposals go through, then HM Treasury will also need to amend CA 2011, s 105 to enable housing associations to do this unless HM Treasury is going to offer housing associations 100% compensation.

DB: If CA 2011 is amended, that could still mean that the final decision on whether this could happen would have to be taken by the Charity Commissioners rather than HM Treasury or an individual housing association. Framing these proposals could be quite challenging, as they will need to be drafted to avoid giving carte blanche to all charities to do the same with any other trust assets.

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