JOSEPH ROWNTREE FOUNDATION

REPORT

INNOVATIVE FINANCING OF AFFORDABLE HOUSING
INTERNATIONAL AND UK PERSPECTIVES

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What can we learn, from international best practice and from within the UK, that could help support the expanded financing of affordable housing supply?

This report reviews international evidence from selected case studies, as well as examples from specific UK nations. It also looks in detail at a small set of specific promising case study policies.

- In a challenging fiscal context, innovation is needed to stretch limited public subsidy and increase private contributions to help deliver additional affordable housing.
- The evidence review indicates that in order to encourage new investment, supply is likely to be at the affordable rather than the social housing end of the spectrum. This is despite the pressures on Housing Benefit and high and increased levels of housing need.
- While interesting ideas that are worth exploration and possible transfer are evident, financial measures such as those discussed here need to be understood in a wider policy context of housing system failure and the continuing need to support new housing for those on low incomes.

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EXECUTIVE SUMMARY

Financing affordable housing supply

Public funding cuts and scarce mortgage credit have made it much more difficult to finance the supply of new affordable housing. This study highlights promising policies from the UK and abroad that provide innovative funding ideas to increase the supply of below-market-price housing.

Key points

- The general shift upmarket to supply shallower subsidy and affordable rather than social housing means higher rents and more limited security of tenure. This will have profound consequences for people on low incomes.
- This movement, amplified by innovations found elsewhere, suggests a number of emerging themes. On the one hand, there is a desire to use more state-backed guarantees, encourage competition among providers, sweat existing assets and encourage alternative sources of provider income. On the other hand, opportunities also exist to 'blend' different subsidies creatively and encourage solidarity-based co-operation among providers.
- In the longer term, fundamental market failures such as in the land and credit markets will need addressing, and funding programmes for social housing prioritised if rising housing need is to be met. This will need to be part of a clear, overarching policy vision identifying the overall mix of policies, which would also need to include how they are to be delivered and by whom.

Background

Alongside a companion study on land supply (by the University of Cambridge), this review draws on national and international evidence on innovative ways to support financing for new affordable housing supply. It is set in a context of declining public funds for housing and mortgage market failure. Recent housing policy has focused on low-income households, because home ownership and liberal mortgage lending catered for the great majority. This is now threatened. The government seeks to encourage private sector participation in higher rent intermediate or affordable rented supply, rather than traditional social housing. This gives rise to tensions, because financial logic shifts the focus to the mid-market, whereas housing need suggests a requirement for more social housing.

Emerging themes

Despite an appetite for state-backed guarantees, caution is required. Guarantees have been debated in Europe as sources of unfair competition. Currently, given prevailing interest rates, investors may receive guarantees less warmly simply as a mechanism to reduce borrowing risk and hence the cost of borrowing. Moreover, recent financial governance problems associated with Dutch social housing are a warning to the UK. There have been concerns about market distortions associated with state-backed guarantees. However, the Scottish National Housing Trust offers a low-cost intermediate solution with potentially flexible exit routes, and including more long-term and social provision options. Competition or contestability among providers (both for profit and non-profit) is important, encouraging efficiency, lower subsidy costs and experimentation.

The evidence suggests that subsidy can be distributed from the centre (national tax authorities or federal programmes) to lower tiers of government, which have more local freedom to augment subsidy (with land, for instance) for locally tailored, affordable solutions. Such arrangements are possible in the UK. Subsidies from different tiers of government and agencies in federal/devolved systems could be combined, as a more discretionary and flexible use of subsidy. Again, this can promote experimental, tailored solutions.

Innovation in housing policy is increasingly 'bottom-up', with national policy responses framed around relatively simple supports that can be locally blended and augmented to serve different purposes. However, the need for value for money means that tests are required to ensure that subsidy is not over-provided or poorly targeted. Regulators could oversee subsidy systems, through tests by relevant agencies checking for value for money, or by incentivising bidding mechanisms.

Various European systems indicate that social housing can benefit financially (and in its governance) from more solidarity-based or collaborative structures. While this may not be culturally translatable to national non-market housing systems in the UK, it may be feasible on a smaller, more local or specialist scale, such as community-based housing association clubs within a city-region. Collaborative models such as pooling and recycling surpluses and linked revolving funds – i.e. recycling original funding – could operate alongside subsidy mechanisms encouraging lower cost and less-per-unit subsidy through competition.

Policy-makers and providers are increasingly interested in management income streams associated with real estate investment trusts, sale and leaseback vehicles and tax credit models. Additional revenue is also increasingly important to social providers, but is not a guaranteed source of income. In contrast to complex schemes, simple schemes which users can understand are valuable, as the effects are easy to follow and unintended consequences less likely. Canadian 'silent mortgages' (like second mortgages but where the repayment terms are flexible and may in fact be discounted in different ways) and policies like revolving funds possess these features.

The shift upmarket in rent levels has meant relatively shallow subsidy per unit, so that more units can be funded from a given sum of public money. If the overall funding programme still operated at pre-austerity levels, this resource could be stretched in terms of units completed. But mechanisms like the Affordable Homes Programme operate at much reduced scale (they also risk not delivering the planned scale of output). The other key measure is 'sweating' providers' existing assets. The Affordable Homes Programme is such a process, capturing the rise in balance sheets and financial capacity associated with the property boom. This is a more volatile, risky approach.

It depends on asset growth and maximum gearing of loans, raising new financial governance and regulatory requirements.

The scope for innovation is closely related to the regulatory context – not just social housing governance, but also the interface between non-profit housing and the private financial sector and its regulation. Public accounting rules also determine the degree of flexibility and providers' financial capacity to borrow when subsidy, public loans or guarantees are involved.

Transferable international policy examples

Many policies have merit for the UK context, but measured against the tests outlined above, six have particular potential:

1. *The Spanish VPO ('officially protected housing') developer/occupier new supply subsidy.* This has provided scale, responsiveness and efficient subsidy but, while means-tested, has been less tightly targeted and has somewhat succumbed to the economic crisis. It is flexible in principle, if not completely transparent. The scheme is readily transferable as it would not require new institutional infrastructure, and could stimulate activity.

2. *The Australian National Rental Affordability Scheme (NRAS) tax credit application of the US low-income housing tax credit model.* The combination of competition among providers, opportunities to blend subsidy and beneficial placemaking (designing and managing public spaces through ongoing consultation with the local community) are attractive innovations. NRAS targets moderate income households, with capped subsidy, and can operate responsively and to scale.

3. *State-backed loan guarantees on the lines of the Scottish National Housing Trust*, rather than as a way of generally lowering the cost of bonds (as the new English £10 million fund will do), or *a Dutch-style guarantee and governance model.* The Scottish model offers tailored outcomes and is only a marginal public finance commitment.

4. *Policies to assist sustainable home ownership.* These include first time buyer policies that assist with deposits, via the Canadian silent mortgage or adjustment to FirstBuy or NewBuy models, such that the indemnity allows for a slightly higher (or more conservative) deposit percentage than the 5 per cent currently in practice.

5. *The Danish housing association national surplus fund.* While based on solidarity principles that may seem alien to the UK, this allows creative use of surplus funds, though the government may simply offset the fund with lower subsidy. However, this may be a more acceptable way voluntarily to unlock housing association long-term 'free' reserves.

6. *The Irish model of private renting with a discounted long-lease rent.* This addresses work incentives and augments affordable supply by binding private landlords into long leases and sub-market rents. This model has grown quickly in Ireland and may act to limit future social security expenditure.

Conclusion

A strategic housing policy needs suitable framing within a long-term policy vision rather than tackling crises as they arise. Long-term housing policy needs to address market failures such as in the credit market and seek to permanently reduce housing market volatility. That means re-examining housing taxation and the safety net for vulnerable home owners. It would also mean supporting the private rented sector's wider market role (for example through developing investment linked to Self-Invested Pension Plans). Long-term flexibility in housing supply needs to be increased systematically, which will involve changes to the land supply and planning system.

Caution is required to avoid hasty transfer of policies from abroad. While this review has identified interesting ideas with potential value for the UK, it would be important to test their performance and assess their institutional suitability for transfer (e.g. the role of welfare benefit regimes in shaping and sustaining housing supply).

The financial crisis and its ramifications have initiated a fundamental reassessment of how to provide non-market housing, who will receive it and on what terms. Affordable housing policy, while financially much reduced, is remarkably fluid and subject to innovations and novelty. It remains essential that such innovation be securely located in a long-term policy framework that is coherent, progressive, inclusive for those in pressing housing need, and consistent with tackling market failures.

INTRODUCTION

This report is a contribution to the debate concerning the search for innovative ways to support the financing of affordable housing supply. It looks at detailed international evidence from selected case studies as well as potentially transferable examples from within the UK.

The report starts with an introduction that sets out the aims of the project and how the team addressed the research brief. The first substantive section describes and reflects on the challenging context for new affordable housing supply and on the pivotal role that finance plays. This is followed by (Chapter 2) a selective overview of the contemporary research and policy literature. Chapter 3 reflects on the issues raised thus far, before setting out the approach taken to identify and examine a small set of promising UK and international financial models that may encourage new affordable housing supply. The next three chapters consider our findings region by region before reaching the synthesis and conclusions in Chapter 7.

Project objectives

The aim of the research is to critically review the international and UK evidence (that is, across the four devolved nations, as well as the special case of London) concerning innovative ways of financing low cost housing across all tenures. The study asks which models have the potential to produce the most housing in the short, medium and long term. A supplementary question asks what reforms would be necessary to adapt the most promising international/UK approaches (and which models require further analysis or testing)?

Research design

The project team conducted a search of academic and grey literature at the UK and international scale. Drawing our own policy networks (for example, in the UK, Europe, North America and Australasia), team members developed a long list and then a focused short list of promising candidate policies or programmes. This 'search' was augmented by in-country local experts in different parts of Europe who completed pro formas on low cost housing funding models in specific countries and conducted a targeted grey evidence search on our behalf. Expert colleagues in both Australia and Canada provided additional support. The analysis was completed to a pre-determined set of criteria or 'tests' (set out below in Chapter 3), which we use in our analysis in the evidence chapters (Chapters 4–6). We also held a valuable meeting on 22 June 2012 in Edinburgh. We were able to piggy-back on to a separate international project (*New Times, New Businesses*) run by the University of St Andrews and this provided the opportunity to debate emerging ideas with the project team, academics and affordable housing practitioners from across the world.[1]

1 BACKGROUND AND CONTEXT FOR THE STUDY

The affordable housing context is immensely challenging. The search for new financing models to deliver additional low cost renting and owning is therefore an urgent one (DCLG, 2011; Scottish Government, 2011). In the social housing sector investment has slumped while low levels of new provision are reflected in high and rising waiting lists. In the market sector the sluggish economy has suppressed demand, but it is also apparent that credit rationing, for builders as well as consumers, has meant that home ownership is now inaccessible to those who could actually sustain a mortgage but cannot secure a mortgage offer. As a result, there are record low levels of first time buyers with pressures in the private rental sector now both in terms of higher rents and rising overcrowding. Market outcomes lead to unmet needs and a sense of wider system failure having an impact specifically on lower income households.

The challenging context

Annual levels of housing need in Scotland were estimated (2006) to be around 10,000 units. In England, evidence (Bramley *et al.*, 2010) indicated large numbers of backlog need households (of the order of 8.8 per cent of all households) though this would slowly reduce over time (but does not include newly arising need). Research quoted in the House of Commons Communities and Local Government Select Committee report (April 2012) (HCCLG, 2012) highlights the structural inability of house building to eat into these levels of need even before the present crisis arose (see, also, CCHPR, 2012). The imbalance between demand and supply in England is such that *The housing report: edition 2* (CIH *et al*., 2011) contrasts new build supply of just over 107,000 in 2010 (and averaging 150,000 over the last decade) with annual household growth of the order of 230,000 (quoted in CCHPR, 2012, p. 3). Large and in some cases growing waiting lists are to be found in all UK countries. In Northern Ireland, for instance, since 2001, waiting lists have grown from 22,000 to nearly 40,000 and in these ten years housing stress has risen from 10,639 to 20,967 households (NIHE, 2012).

Insufficient supply would be serious enough in 'normal' times, but is further compromised by the economic crisis, fiscal austerity and welfare reform. Job loss, business closure, part-time working and in-work poverty are the sharp end of economic failure. In the housing market, transactions have fallen sharply and stayed lower, largely because of mortgage credit availability problems, but at the same time prices have not corrected downwards to the extent that they did in the early 1990s. Despite, historically low interest rates, market trends and the lack of credit have combined to prevent normal market functioning.

As a result, the market is less able to provide cross subsidy. This fatally damages many of the strategies that were extensively used in the last decade that relied on additional resources either from the provider, purchaser equity or from landowners, such as Section 106 planning agreements. A further consequence is the way the 'new normal' alters what we mean by 'affordability'. Many providers are obliged to expand their activities by shifting provision upmarket, thereby redefining and stretching the idea of affordability and shifting the target group towards intermediate rent.

The evidence review will therefore need be to be clear about different ideas of affordability as well as different financial models so that one can identify models that may help those with least resources. The very concept of affordability is an inherently slippery and perhaps unhelpful one. In addition to funding benchmarks used by government agencies (for example, the level of rent allowed that can repay debt), affordability has three dimensions that do not necessarily operate in the same way in different national contexts:

- How are 'affordable' housing costs set relative to market equivalent benchmarks? Are they at social rent levels as understood in the UK or placed somewhere intermediate to the market level, or are they 'capped' as a proportion of recipient income in some way (for example, in relation to welfare benefits)? In order to make private investor returns viable, rents are increasingly expected to be in the intermediate zone between social and market rents (known as mid-market or intermediate or just sometimes affordable rents).
- Tenancy security also varies between the market level and social renting and 'affordable housing' is increasingly towards the market end of the spectrum, but there clearly could be a trade-off between tenure (that is, occupancy length) security and relative rent level.
- Access to housing and relative need also varies according to the spectrum between market, affordable and social housing. Again, allocation to affordable housing is not necessarily targeted as strictly as social rented

housing (for example, the focus may be on key workers and an income ceiling may apply).

Therefore, being clear about what we mean by low cost is important both analytically and politically.

This is the context in which the UK and devolved governments are exploring alternative financing. All governments are facing departmental spending cuts. Not surprisingly, these fall heavily on capital funding-intensive housing programmes. Pawson and Wilcox (2011, pp. 74–81) summarise the impact of the housing cuts arising from the 2010 Spending Review:

- There was a reduction in England in the total dwellings approved from 58,000 to 20,000 comparing the 2008–9 to 2010–11 programme with the 2011–12 to 2014–15 programme. This is achieved in part by a fall in grant from £8.9 billion to just £1.8 billion comparing the two programmes.
- Scottish public investment in affordable housing fell less, though still, in real terms, between 2011–12 and 2014–15 by 36 per cent (45 per cent cash).
- Welsh spending on housing association capital development peaked at £135 million in 2008–9, but thereafter declined, falling to £48.1 million in 2013–14.
- In Northern Ireland, investment in new housing association (voluntary sector) housing grew to £183 million in 2010–11, but will fall to £122 million in 2012–13.

Moreover, governments will have to deal with the consequences of higher levels of need brought on by the recession, demographic change, the lack of access to market alternatives, and now also deep cuts to, and restructuring of, key personal subsidies, in particular, housing benefit. The changes to housing benefit will have marked impacts in high cost regions such as Greater London, but will also significantly affect single people in private renting, under-occupiers, non-dependents and those in large households.

Strategic responses?

DCLG announced *Laying the foundations: a housing strategy for England* towards the end of 2011, supplemented by a *Housing Stimulus* package announced in September 2012. Four major measures proposed were: reinvigorating the right to buy (RTB) scheme with an attempt to guarantee replacement social units, the re-use of public land to build up to 100,000 units (*Build now, pay later*), reform of planning as part of the Localism legislation and, the *NewBuy* mortgage guarantee or indemnity for new build (alongside a *FirstBuy* scheme co-funded by the public sector and house builders to provide 20 per cent equity loans for first time purchasers seeking to buy new homes). Other related initiatives from this period include the *New homes bonus* (aimed at encouraging councils to grant planning permission for new homes by offering additional revenue through matching council tax for six years, and the *Growing places fund* that supports infrastructure which facilitates housing and economic growth, and the *Get Britain building fund* (a new fund to support development finance).

At the same time other longer term streams of work have included the consultation over social REITs (see Chapter 6) and the Montague Review (2012) of the barriers to institutional investment in the private rented sector, which called for reform of planning, including flexibility regarding Section 106 agreements to favour private renting and for more land release if a proportion of market renting was included in developments. The Montague Review was supported in the government's *Stimulus package* (House of Commons Library, September, 2012). As part of this initiative, the government also proposed making £10 billion of guarantees available to underwrite new housing debt by housing associations (and private developers). In response to the negative effects of proposing freeing up Section 106 obligations in order to stimulate private house building, the Government also proposed additional funds for 15,000 homes to compensate for those lost under the Section 106 changes.

Affordable Homes Programme (AHP)

The AHP replaced the mixed funding programme for housing associations with new supply premised on shallower grants, higher rents, fixed-term tenancies and revenue subsidy from charging higher rents on vacant relets of existing property. The AHP is premised on the exploitation of the positive housing association balance sheet effects of rising property values on financial capacity prior to the global financial crisis (GFC) (Public Accounts Committee, 2012). The AHP is expected to deliver 170,000 units, largely towards the end of the 2011–15 period though a proportion of the programme has been compromised by (a) the unwillingness of some local authorities to allow what they consider to be unaffordable rents and (b) the impact of the proposed increased flexibility over revisions to the Section 106 agreements. These policies are controversial and have been subject to critical scrutiny (see, for instance, the CLG Select Committee Report, 2012 (HCCLG, 2012); the Public Accounts Committee report on the Affordable Homes Programme, 2012; CCHPR, 2012; and *The housing report: edition 3* (CIH *et al.*, 2012).

In Scotland, the SNP Government produced *Homes fit for the 21st century* (SG, 2011). This aimed to boost affordable housing supply by around a target of 30,000 social and affordable units over the five years of the Parliament, two-thirds of which would be for social rent and 5,000 would be new council housing. Housing association general needs housing would be supported at historically low average grant levels of £40,000 per unit (£30,000 for councils). The total would also include units delivered through the National Housing Trust mid-market rent initiative, lower subsidy housing association development, shared equity and a range of innovation projects and initiatives to support supply (such as infrastructure funding support). The first year of the Parliament (2011–12) delivered 6,800 social and affordable units (though these completions were largely funded on earlier, more generous rules).

In 2010 the Welsh Government produced *Improving Lives and Communities: Homes in Wales* (Welsh Assembly Government, 2010), which highlighted the importance of building more affordable housing against the backdrop of the 2008 Essex Review (Essex *et al.*, 2008) of affordable housing and public finance challenges. A range of proposals sought to meet this challenge including the development of a Welsh housing bond or investment trust, bringing forward more publicly owned land and reforming the housing revenue account (HRA) subsidy system.

The Northern Ireland context is informed by the deepest reversal in any housing market in the UK. Into this context, the Northern Ireland Housing Executive is to be restructured, potentially releasing funds for investment in affordable housing. The Northern Ireland government is pledged to deliver 8,000 social and affordable units between 2011–15 which matches aggregate need estimates but is within the context of a fall of a third in capital spending on housing (NIHE, 2012). Meeting the target is described as 'very challenging'.

The *Revised London Housing Strategy* draft published at the end of 2011 by the Mayor of London (GLA, 2011) takes place in the context of increased strategic housing powers as a result of the localism legislation. London faces housing affordability problems on a scale unique in the UK – for example, 700,000 additional households are anticipated over the next 20 years and nearly 250,000 households are overcrowded. The scale of the affordable supply response is also correspondingly large – more than 14,000 affordable units were completed in 2010–11 alone. High land prices, competition for space and the challenging public finance circumstances nonetheless make affordable provision very challenging.

Later in the report we will look at several of these current and potential initiatives in more detail. Before moving on to that stage, however, we first briefly overview key published research and academic literature.

2 OVERVIEW OF EXISTING KNOWLEDGE

In the current climate, there have been a number of relevant studies. Recent research and policy publications in the UK include: the Essex review of affordable housing (Essex *et al*., 2008), the Semple affordability review (2007), Morton (2010), BHSF (2011), CIH (Scotland) (2009), O'Sullivan (2010), Hall and Gibb (2010), Whitehead (2010), Oxley *et al*. (2010), Williams *et al*. (2011), Hull and Cooke (2012), Clarke (2011), Gibb (2011), Cambridge Centre for Housing and Planning Research (CCHPR) (2012) and House of Commons Communities and Local Government Select Committee (2012). A further international comparative study on similar terrain is Lawson *et al*. (2010).

The Essex Review of affordable housing in Wales was published in 2008 (Essex *et al*., 2008) and made a number of relevant recommendations. This included the use of land, cross-subsidy, cheaper finance and increased leverage, as well as more borrowing capacity. This led them to look at housing associations' assets and rent regimes, the Welsh HRA system and its reform. In Northern Ireland, the Semple review of affordable housing (2007) concluded that more planning instruments were required along the lines of S106 agreements in England, and that more community land trusts were needed, and a more proactive role by government agencies to make land available. It also found that more support should be offered to successful intermediate products such as the Northern Ireland co-ownership housing association and that grants should be made available to bodies other than housing associations for the delivery of social or affordable housing.

Policy Exchange produced a radical set of proposals (Morton, 2010), identifying the rising and high costs of housing as well as critiquing British social housing and its underlying incentives. The proposed solutions include reforming social housing to make it a route into home ownership through changes in allocations and priorities centred around fixed-term tenancies. The report proposes the nationalisation of housing associations and council housing in order to facilitate a new RTB programme and sell off the existing stock as it becomes vacant. They would also facilitate a 'path to ownership' model wherein bonds would finance new build and rents would repay interest. Tenant payments would allow them to build equity in the ownership of their home. Alongside these measures would be a series of planning and fiscal policies to stimulate new supply and help low-income would-be mortgagors.

The Institute for Public Policy Research (IPPR) (see Hull and Cooke, 2012) argue that what is needed involves new financial sources to support house building. Local authority pension funds should be encouraged to invest in housing. A national investment bank should be created and provided with capital, and the accounting rules facing local government should be altered to be akin to general government (that is, allowing trading and borrowing). They argue that housing capital expenditure by government should be made a priority (suggesting an additional £750 million per annum for each year of the next spending review period). They also argue that the development sector needs to be shaken up with government acting as a clearing house on leftover land banks from failed businesses. They also propose rapid build out through public land programmes and incentives (for example, equity stakes) to encourage councils and the London mayor to release more public land for housing. Another fiscal lever proposed is a land value tax on undeveloped but developable land worth more than £2 million per site. Most radically, they propose an 'affordable housing grant' combining housing benefit (HB) spend and capital spend and this would be given to local authorities: it would be up to them to decide how to use it to meet housing need, increase access and build homes.

Two think tanks, therefore, so different politically, have arrived at the need for (all or nothing?) radical restructuring of the housing system as a whole. They also share important ideas – such as fixed-term tenancies, the need to reduce the price of housing and expand supply. In contrast, the Building and Social Housing Foundation (BSHF, 2011) recommended that local authorities (supported by central government) should take greater strategic and operational leadership to assemble and parcel land to allow different providers to build. Second, incentives, tax and regulation need to be reconfigured to encourage land to be brought forward by landowners. Third, development finance and also mortgage finance need to be encouraged to be more forthcoming. A number of further specific proposals involved local authority guarantees, redefining local authority accounting practices along the lines of 'general government', the greater use of community land trusts and incentives to encourage empty homes back into productive use.

In Scotland, the Chartered Institute of Housing has produced two volumes of proposals (CIH, 2009; O'Sullivan, 2010) which outline practical ways to deliver more affordable housing that included:

- a local housing fund combining local bond issuance, public sector contributions to support infrastructure and locally-led first time buyer/ low cost mortgages. The latter could also involve council guarantees;

- co-operative and mutual home ownership models;
- councils operating as builders and social housing lenders;
- redefining the public sector accounting practices to exclude local government and council housing from the borrowing controls exerted over the public sector;
- loan guarantees for the use of supporting new affordable housing based on the models applied to the SME sector in the UK (and also the National Housing Trust), which may additionally reduce the cost of finance;
- revolving funds and the Highland land bank fund;
- community land trusts;
- REITs as a possible vehicle for affordable housing;
- mid-market rent and the Rettie Resonance model (a partnership between developer and social provider involving deferred land costs, and, in the case of the Edinburgh based examples, a fixed rental risk contingency provided through City of Edinburgh Council's affordable housing funding and agreed with the Scottish government).

Several of these ideas are discussed in more detail in Chapter 6. More recently, also for CIH (Scotland), Clarke (2011) has explored the scope for joint ventures, equity and bond investment and the various subsidy and loan guarantee ideas normally through mid-market rent models (required to earn the necessary returns) including the government sponsored National Housing Trust and the Resonance model.

Monk and Whitehead (2010) and Whitehead (2010) examine the scope for shared equity and other intermediate products for home ownership. Market conditions will be critical to their success and the continuing failures in the credit market suggest limited opportunities. Oxley *et al.* (2010) and Williams *et al.* (2011) consider the scope, limitations and international lessons regarding institutional investment in private renting. This also concerns the scope for REITs and their possible evolution into affordable housing. Part of the case for Social REITs and the Montague proposal derive from this type of research indicating that such opportunities will not be crystalised without change to the institutional arrangements (but even so, it is not certain that large-scale investment will follow – investor appetite remains uncertain).

The CCHPR (2012) analysis looks at models to deliver more affordable housing but in a context that recognises the need to operate in both high and low demand areas and in a way consistent with financial capacity (both the supply of funds and rental or mortgage cost affordability). Their international evidence involves:[2]

- Austria and its housing construction convertible bonds – a protected housing finance circuit with tax-incentivised bonds specifically for affordable housing;
- China's inter-governmental financial system which encourages local government to use land sales to the private sector. While this may include incentives to support high-end housing, there are examples where the sale of the use rights of public land as a way of raising finance for affordable housing;
- France and the *Livret A* savings scheme – initially, a specialist provider of social housing finance (Credit Foncier) transformed short-term individual deposits into cheap long-term loans for social housing. *Livret A* savings schemes are now provided across the French banking system and have been particularly popular as they offer the general public tax-free savings and security in the context of the financial insecurity of the GFC;

- Hong Kong's self-finance public housing (though it has historically enjoyed free public land and important sales revenues to help subsidise household housing costs);
- Singapore's compulsory employees' social security housing savings fund, in place since 1955;
- Switzerland's guaranteed co-operative housing bond. Apart from the ability to buy discounted land, the Swiss social sector relies on revolving funds, bond arrangements and a federal mortgage guarantee to co-operatives.

CCHPR review an exhaustive list of contemporary and recent UK initiatives. The main models reviewed are:

- new homes bonus;
- revolving land bank funds;
- loan guarantees, including by the Scottish government;
- Section 106 agreements and the community infrastructure levy;
- real estate investment trusts (REITs);
- private finance initiative (PFI) and tax-increment financing;
- special purpose vehicles partnering with private developers;
- local asset-backed vehicles or local housing companies;
- new supply shared equity;
- bond finance including The Housing Finance Corporation (THFC), housing association and local authority bonds;
- institutional investment such as pension funds;
- sale and leaseback;
- charity and ethical banks;
- community land trusts.

CCHPR conclude that all of the models have strengths and weaknesses (weaknesses include over reliance on public subsidy, dependence on market cross-subsidy, or that they are just too new and different for the sector) but, in particular, any serious cross-national application of innovative models needs to be placed into a suitable context. They conclude that local fiscal incentives and local institutional structures for mobilising savings or capital set against the local regulatory context for affordable and social housing are important general success factors (p. 32).

The CLG Select Committee (HCCLG, 2012) included evidence on specific models such as social REITs, institutional investment to the private rental sector, indemnities to support first time buyer new build purchases, creative proposals for the treatment of historic grant on housing association balance sheets, as well as other models relevant to this study – we examine these in Chapter 6.

Finally, Lawson, Gilmour and Milligan (2010) investigate six examples of 'developed' and 'well-established' national housing systems and assess the quality of a given aspect of each with a view to learning lessons for delivering effective financing for affordable housing. They consider:

- France (*Livret A* tax privileged deposit scheme for affordable housing);
- United Kingdom (THFC's syndicated bond model);
- United States (low income housing tax credit);
- Switzerland (loan and bond and public guarantee system);
- Austria (housing construction convertible bond instrument);
- Netherlands (social housing mortgage guarantee scheme).

The increasing use of public guarantees is noteworthy in countries like Switzerland, Sweden, Netherlands and Scotland (and are now planned to back housing association bonds in England and Wales). This is despite qualms expressed in some quarters about possible market-distorting effects (Montague, 2012).

> Lawson *et al.* (2010, p. 2) draw conclusions from their work on financing models that can generate affordable housing supply. They present a clear sense of what should be considered in a policy framework for housing:
>
> - A clear public vision, goals and targets for affordable housing should be developed from the outset so that policy is not dictated by the needs of private finance.
> - Private finance mechanisms can be strategic and cost-effective but they need to be carefully structured to fit the local institutional context.
> - Appropriate industry norms and an effective regulatory framework are essential.
> - There needs to be an appropriate balance of demand and supply subsidies within a national framework with local delivery and flexibility;
> - Government not providers should ensure low income tenants have their income supported to help with housing costs.
> - Housing providers should be responsible to deliver efficient services and competition should play a part in keeping costs under control.
> - Income mix in schemes should be used both to integrate communities and use revenues creatively to support development.

The main implications drawn from this chapter's review are:

- Affordable housing requires subsidy, though that subsidy may take many forms. There are no simple market solutions that seem capable of producing low cost housing without subsidy. This has consequences for those on low incomes.
- The understandable efforts to develop private sector participation in new models, alongside the requirements they bring (for example, minimum rates of return and exit routes) necessarily narrows the window of what is possible and, for instance, makes higher rents (for example, mid-market or intermediate) affordable rather than social rents a necessity, which leads to a shallower subsidy model.
- Private sector participation has knock-on effects elsewhere in the system, such as higher benefit costs (linked to higher required rents) and for non-profit governance (for example, for charitable housing associations the need to set up subsidiaries to achieve market rents but who will still need to justify any capital investment in such a subsidiary in terms of their charitable objectives).
- More broadly, any international policy transfer has to take proper account of the origin and destination of national housing systems, including their

interaction with the welfare benefit system and the governance and regulation of affordable/social housing providers.

- Many models and approaches exist or can be conceived, but they all have strengths and weaknesses when set against key policy transfer criteria (discussed further below).
- Within an articulated policy framework for affordable housing, clear aims and objectives are required, not just about individual policies, but also concerning the mix of policies and their system-level coherence, including how they are delivered and by whom (especially relevant to a devolved system).

3 REFLECTING ON OUR APPROACH

A number of themes warrant further elaboration. First, is the meaning and measurement of affordability – a long-standing concern heightened by the proliferation of different measures and definitions in a world that increasingly relies on intermediate housing propositions. We know that such products are often directed to those working yet are unable to access the market (and may operate with an income ceiling). It is also often defined in terms of a fixed length of tenancy – it is about terms and conditions more widely and not just cost discounted to a market benchmark. If state-funded housing investment is increasingly directed to this segment of the housing system what is to be done in terms of housing and low income households at the social housing end of the spectrum?

A second key area is methodological and concerns the possibility, risks and difficulties associated with international policy lesson learning and policy transfer (Stephens, 2011a; Dolowitz and Marsh, 2000). Housing policies operate within housing systems and these in turn interact with wider social and economic structures (Stephens, 2011a, p. 353). Stephens defends careful housing system comparative research (including for policy transfer) provided we are clear about the role of a given policy's underlying housing system, the relationship with path dependency and relevant institutions. However, this comparative dimension is not just an *international* methodological theme but also is increasingly relevant to how we think about housing policies and models *within* a national but devolved housing system exhibiting important degrees of divergence in policy aims, instruments and delivery networks (Wilcox *et al.*, 2010).

Third, it is difficult not to conclude that there are bigger structural questions and wider market failures to address. We have alluded to the credit market failure but we also recognise long-standing supply inelasticity problems that create chronic market volatility and a failure to address high and rising levels of need (including an ageing society with insufficient resources to meet its growing care requirements). At the same time, the dysfunctional relationship between housing policy, taxation and the benefit system remains problematic and is exacerbated by fiscal austerity. Should we not focus on the wider system failures and address them in order to lessen the constraints facing the sector? Again, we will return to this longer-term agenda in the conclusions.

Fourth, the context and literature review suggest that we need to think systematically about criteria for selection of promising models and policies. The analysis will be organised around a common set of evaluation criteria or 'tests' (see Hall and Gibb, 2010). The criteria we envisage using would include:

- *simplicity and transparency* of model (for example, can stakeholders understand and apply the model; does it overcome critical hurdles such as EU State Aid policy?);
- *Whom does it house*? (for example, is the policy targeted at the poorest, those on moderate incomes, or specific life cycle stages (for example, young households without assets) and how is the policy measured or defined?);
- *value for money* for the taxpayer and implied subsidy levels and distribution of risk;
- *robustness and sustainability* (that is, long-term relative insulation from risks and capacity to ride out economic and other 'shocks' over the duration of time required for funding);
- *volume* and the potential of policies to achieve scale;
- *efficiency* (concerned with dimensions of relative low cost, low waste, the avoidance of 'dead weight', targeted to objectives and minimisation of unintended consequences, for example, crowding out, or pushing prices up);
- *effectiveness* (that is, practical performance reaching target groups and alleviating housing-related problems).

Of these criteria, the priorities are: scale of new supply and whether it reaches critical mass; the pace and certainty of deliverability of the policy; the nature and the depth of the subsidy implied (as there is always a subvention of some form) and its impact on public sector value for money; a sense of who is ultimately targeted and how efficiently this is delivered by the policy; and overall effectiveness. Where appropriate, we also consider the private sector's appetite for such a policy.

4 NORTH AMERICA AND AUSTRALIA

Overview

The analysis covers three countries, namely Australia, Canada and the USA.

Australia

The Australian innovation example selected is the National Rental Affordability Scheme (NRAS). It allows blending of different kinds of tenure and client groups within specific projects. Funds can be contested by for-profit and non-profit providers.

The intentions: affordability, variety and competition

NRAS was introduced by the federal government in 2008. Two periods of policy were envisaged, the initial roll-out from 2008–10, and then full scale delivery from 2010–12. The overall programme delivery horizon has now been extended to 2014. NRAS aimed to provide 50,000 rental dwellings over the policy period with a likely total cost to the exchequer (federal and state contributions combined) of close to $4.5 billion (£2.967 billion).[3]

NRAS was designed to

- attract the interest of institutional and other private finance into rental housing and do so at scale (particularly in its recent third phase). This would involve both non-profits, including charitable associations, and private investors in providing and owning housing;
- encourage contestability between non-profits and private landlords not only in ownership of rental property but in providing management services;
- provide incentives for developers and owners to blend NRAS with their own funds and with other forms of assistance arising from tax breaks, grants or favourable planning and planning gain arrangements.

Like the Low Income Housing Tax Credit (LIHTC) in the USA, NRAS is based on a tax incentive. Thus, the policy responsibility for this major housing policy lies partly with the Australian Tax Office and partly with the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA).

The initiative was conceived as both a response to secular renter affordability problems and also as a contribution to stimulating demand in the economy in response to the post-GFC downswing. It is aimed at key workers (many of them in receipt of social security – the benefit in question is Commonwealth Rent Assistance (CRA)) with the intention that they do not spend more than 30 per cent of their household income on rent. The federal government have identified that around 1.5 million households could be eligible (though this does not imply a similar total of units would be required to stabilise rental levels).

In order for investors and developers to be able to claim NRAS support they must offer to provide properties that can be set at no more than 80 per cent of market rents and that tenants have eligible income limits.[4] At this stage of the programme it appears that its design to aid affordability for moderate and low-income households has been effective and that properties are being let readily to the intended client groups. NRAS has variety in its client group. NRAS support is also applicable to a broad range of property types. According to FaHCSIA, a variety of dwelling and neighbourhood types are amenable to policy action within the programme.

There is also an intention to support a variety of kinds of investors. In many ways NRAS typifies forms of subsidy schemes that are emerging in the current times of scarce government resources, market failures in finance and rental service provision and, of course, unrelenting pressures across rental sectors. Historically, subsidy design within Treasury and Finance Ministries has tended to favour subsidy schemes that had clearly, and often narrowly, designed target groups and that tended to serve a single purpose. Now it has a broad range of possible uses, with scope for blending and matching with other subsidies, and gives NRAS-like schemes diverse and catalytic roles.

NRAS is a deliberately contestable subsidy (that is, it promotes competition between different providers, for-profit and non-profit) and it allows intervention across a relatively comprehensive spectrum of lower- and middle-income market rental provision. Part of its appeal is that it is not narrowly targeted. As such it can be said to be a useful policy instrument for fostering a locally flexible approach to meeting housing needs and demands.

The NRAS instruments

NRAS involves a tax credit to private (tax-paying) investors or the payment of an equivalent amount of grant level to non-profit and often charitable affordable housing providers. In relation to private investors, the typical landlord in Australia is a small-scale ('mum and dad') investor, but NRAS also aimed to attract institutional investors, not only to raise the flow of finance but also to 'professionalise' financing and management in the private sector. In the US the importance of the LIHTC to taxpayers/investors has been argued to be an important dimension of the politics of maintaining housing subsidies. That is, the 'lobby' is not simply the landlords and potential renters but also the savers/taxpayers who invest. The longevity of LIHTC is often ascribed to this diversity of support. NRAS may not, however, yet be on a sufficient scale to make the 'investor/taxpayer' vote matter in federal elections.

In essence, NRAS offers annual incentives for ten years (indexed annually to the rental component of CPI.) The two key elements of the incentive are a Commonwealth government incentive currently of \$7,486 per dwelling per year (or £4,936.37) as a refundable tax offset or payment, and a state or territory government incentive, currently of \$2,495 per dwelling per year (or £1.645.24) in direct or in-kind financial support.

This government's support is committed for up to ten years, and this means that the overall value of the subsidy (given indexation) is close to \$95,000 per unit (£62,644). NRAS is relatively generous to market investors.

To date it appears to have generated gross rental returns of close to 7 per cent, as opposed to a more typical market return of 5 per cent.

It needs to be stressed that the NRAS tax break is not only additional to other renter tax breaks, but also widely supplemented by other forms of support including (according to FaHCSIA): loans; equity investments; capital grants by Commonwealth, state and territory or local governments; donations by charities; free or discounted land by churches; or contributions by developers in accordance with planning requirements. In addition to this, many state and local governments have provided generous planning incentives where NRAS approved dwellings are to be built. In ex post evaluations of value for money in NRAS spending it will be essential that tranches of support can be co-identified with both the income of clients supported and with the other diverse subsidy supports applied.

Government does not hold any residual claim on the equity given to investors, as NRAS is a 'fund and forget' strategy. Should an investor decide to leave the scheme there is no mechanism to reclaim the support allocated in earlier years. The federal government's main roles are in allocation of NRAS permissions and state governments have continuing roles in ensuring that properties are let within the eligibility limits and that services provided meet state standards. Arguably NRAS appears to have been designed to ensure speedy delivery of policy change rather than to ensure maximum efficiency in the delivery of policy aims.

It was noted above that the Australian government had sought a variety of potential investors and developers in the MRAS programme. In order to do this they not only made non-profit (non-tax paying) provider support available as an annual capital grant but also provided comfort that charities could also deliver a commercial service as long as their core aims were charitable. This is a flexibility in shaping the market–non-profit interface that has been missing in the UK, reflecting the costs of setting-up and running non-charitable subsidiaries. The involvement of states in making support in cash or kind has also been important in engaging local interest and in deploying planning and infrastructure programmes as ways of facilitating such investment.

The first waves of NRAS applications and developments were dominated by the non-profit sector. Non-profits are confronted by significant new opportunities including:

- being contracted by investors to provide management services for participating NRAS dwellings;
- teaming up with other partners in joint ventures or consortia arrangements to construct and manage new dwellings;
- applying for NRAS incentives to help construct and manage dwellings themselves.

It is clear that NRAS has encouraged the formation of a new non-profit sector that engages in the provision of both lower-income and middle-income rental housing and that new 'hybrid' organisations have evolved (see Lawson *et al.*, 2010; Maclennan, 2012).

Policy has been modified post 2010 to raise private investment interest. There is no upper limit to the number of NRAS homes which an individual or organisation can own. For instance the Australian National University in Canberra has built a thousand NRAS homes. There is however a lower limit on applicants. In round three of NRAS FaHCSIA advised that, 'As the NRAS aims to encourage large-scale investment in affordable housing, it is not directly available to small-scale, private, individual investors in the rental property market. Direct applications can only be made by those with 1,000 or more dwellings' (see FACHSIA website guidance: www.fahcsia.gov.au).

Drill Hall

The original Royal Melbourne Drill Hall has been completely transformed from a faded 1930 'regimental marching hall', to a modern, high quality heritage restoration, civic complex and well designed social housing development. The project created a significant civic space as well as a city centre service for an Aboriginal health facility. In return, council and the planning scheme allowed for air rights to be used for a nine-storey tower of 59 apartments let to a range of household types including people with disabilities. Housing Choices Australia combined capital grant, private debt, philanthropy, planning gain and tax concessions with NRAS to produce an integrated development in an outstanding city centre location. This is a 'more than market' example of the emerging integrative capacities of new providers.

With these provisions there have been a growing number of syndicates whereby groups of small investors commission a developer to construct an NRAS project and national efforts to market this approach have been significant after 2011. Large-scale institutional investors have still been slow to participate on any scale but Australian experience is similar to other advanced economies in this regard. There exists a strongly risk averse attitude on the part of institutions towards residential property.

The Mariner (NewQuay)

This modern, well-designed apartment block offers housing in a premium city-centre location to people on fixed, low and moderate incomes alongside other dockside residents. It provides key workers with good quality housing within easy access of transport and jobs. The eight-storey development has 113 apartments, 85 of which are owned by a not-for-profit provider. Twenty-eight units were sold off the plan to the private market – mostly for owner occupation. The $1.5m proceeds (£989,120) were then used as equity to cross-subsidise different housing needs, including people with disabilities. NRAS, private debt, equity from sales and capital grants were combined to produce dwellings almost half the subsidy cost of comparable public housing developments.

Conclusions

In broad terms NRAS appears to have been a generally well-constructed scheme with effective outcomes, though no hard evaluation has yet been published. There has been substantial take up of the scheme. Almost all of the possible permissions have been approved, though actual construction, understandably, is lagging. To date it appears that 15,000 units have been completed or are in development and it seems unlikely that all allocated developments will be undertaken by 2014. There is currently a lack of clarity about the resource commitments for the next stages of federal housing policy and the future of NRAS beyond 2014 is uncertain although there is a general sense that NRAS has been an important innovation in housing policy provision.

Of those who have pursued permissions and development, there has been a much greater preponderance of non-profit organisations than initially envisaged. Although private interest has grown over time there has been more success in attracting syndicates of small investors rather than the large institutional investments that it had been hoped would change the financial and operational efficiencies of the sector. Crucially, few institutional investors have committed, mostly because the return is still insufficient compared to other investment options. However, on balance, this has nonetheless been a useful innovation wherein the emerging not-for-profit sector has used the scheme to mix and blend financial inputs, explore new market segments (including mid-market renting) and develop new products.

We believe these are important gains for the Australian housing system for the long term. There has been an acceleration of affordable middle income rental provision, place renewal has been facilitated, a more professional rental sector has been encouraged and there has been contestability and leverage in funding. The parallel development of the social housing initiative makes clear that NRAS was not seen as a substitute for investment in the homes of the poorest people but was, rather, a helpful complement relieving other market pressures.

Canada

The Canadian example focuses on low-cost home-ownership. Canadian affordable housing programmes were severely reduced in the early 1990s. There has been little purpose-built private rental housing built since the 1980s and 'core housing need' (as defined by Canada Mortgage and Housing Corporation (CMHC, 2012)) has remained high, particularly among renters, aboriginal people and single-parent families. Access to home ownership for low and moderate income groups has been reduced due to price increases (despite low interest rates and high production in large urban centres) leading to renters maintaining tenancies and limiting rental opportunities for newly formed households. In Canada home-owners require loan insurance and subsidised loan insurance is only available where households provide a deposit of at least 20 per cent of dwelling prices. This places a significant deposit hurdle for potential first-time purchasers albeit that it encourages both household saving and housing market stability.

Despite the devolution of housing programmes to lower tiers of government in the 1990s, federal governments have subsequently passed bills to support 'affordable housing provision'. In the 2008–9 package of fiscal stimulus measures housing was regarded a fast acting, high multiplier sector and a significant injection of funds was made for the two subsequent fiscal years. The federal government's desire was to have a very temporary and simple programme with no on-going operating costs (one-time grants) and no on-going administration.

In order to deliver this aim, a portion of federal and matched provincial allocations were reserved for access to affordable home ownership. Funds can be in the form of a forgivable loan, grants, or a re-payable loan held as a silent second mortgage (payable at a point in time or on sale of the unit by initial occupier) to individuals. This 'silent' mortgage treatment is the significant innovation in the programme. Different provinces have developed approaches in the use of these funds but the silent loans (Ontario) measures funded by the Affordable Housing Program (AHP) form the focus of the discussion in the paragraphs below.

The policy response to the GFC and the market context was to give some support to housing but, in contrast to the Australian response, to do so through a simple programme with no on-going operating costs (one-time grants) and no on-going administration commitment. The costs of the programme were shared between federal and provincial governments with further options for additional local government participation or augmentation. This was delivered by earmarking a portion of federal and matched provincial allocations for initiatives to promote access to affordable home ownership.

As each province, and in some cases local governments, set allocations, a national figure is not known, or at least not published. Of the approximately $1.4 billion (or £889,67[5]) allocated for the overall AHP 2011–14, it is estimated that 20 per cent will be used for affordable ownership housing.

Spending and action were triggered when funds were allocated by provincial governments in responses to local government plans and indications of support (in cash, land or in-kind). The home ownership element of the AHP can be used to boost production for ownership in a number of ways. A capital grant can simply be made to qualifying individuals to provide a 5 per cent down payment to meet mortgage underwriting requirements. That form of support may be simple, but it is a once only aid to purchaser affordability with all the gains accruing to the first buyer; or it may be a grant contribution that is leveraged for policy purposes with added value from other cash and non-cash contributions (fee forgiveness, land value, planning approvals and labour). These contributions are then aggregated and held as a second mortgage that has to be repaid at some agreed date or upon sale of the house unless loan forgiveness is a local policy choice. The initial purchase price is reduced by the value of the second mortgage, but the fact that this is a repayable 'silent' mortgage rather than a grant means that the funds can be re-released to other qualifying entrants in the future. This is not a 'fund and forget' subsidy, in contrast to NRAS in Australia, but one that can be effectively recycled. If deposit capacity rather than asset returns or inadequate or unstable repayment income is the policy problem in boosting production for ownership then this silent loan approach is an effective approach to the real policy question.

Aside from this subsidy recycling feature the scheme has some similarities to the NRAS rental approach in Australia. It targeted first time buyers in the thirtieth to fortieth income percentile. The grant is a singular amount regardless of the qualified household income or the cost and size of the housing unit delivered (administrative simplicity). The programme was open to private and non-profit housing providers. Local government and other organisations were encouraged to add value to the programme through reducing development permit fees and developer charges relief, tax reductions of postponement, and making land available for new development (often with forgiven or deferred land payments by the developer). The approach is novel, flexible and, like NRAS, is aimed at mobilising and blending wider support.

In contrast to Australia, research on housing policy spending and outcomes in Canada after 2005 (or so) are best described as modest. The federal government publishes relevant information at a snail's pace and the federal budget statements are far from transparent. There is little organised attempt by provinces to produce a bottom-up view of policy and progress in Canada so it is often hard to track programme spending let alone evaluate outcomes. In relation to the overall ownership segment of AHP no national targets have been set. In Ontario analysis of provincial documents indicate that over 1,000 units have been delivered or are in production. No other estimates are available at this time.

Conclusions

The policy has a number of important virtues. First, it has a high degree of intended simplicity, namely, to increase the affordable housing supply and create jobs; it is also simply controlled by government, financial exposure can be capped (by the limit on total grant available) and the size of individual grants can be tailored to local income profiles and market conditions. It could readily be adapted to 'fit' better with UK low-cost home ownership requirements.

It is, second, transparent in important respects, such as in defining the target group, but the proportion of programme funds dedicated to affordable ownership is variable and can be subject to change in ways that do not reflect an objective set of market or other local criteria, but rather provincial or local policy interests; that is, the degree of provincial/local flexibility imply that anticipated outcomes for each locality are different, and the process for this allocation is not public nor well understood.

Third, the programme format allows contestability or competition between different kinds of providers; however, that same flexibility also means that some jurisdictions chose approaches that included contestability of funds and others not. The programme is also clearly targeted at households at the fortieth income percentile; however, it is a limitation that households must meet conventional mortgage underwriting criteria (a lesser test if other contributions are added to those of the programme).

The constraints of the programme are such that only moderate quality homes in second tier locations are produced; some see this as a programme virtue and others do not. Local variations in the size of the grant, and indeed other cost reducing supports, mean that the same federal fiscal effort can have significantly different effects on affordability from place to place because of the way it interacts with local subsidy and market price variation and as a result is more or less generous for the end recipient.

In broad terms the policy seems to be efficient in that there is a simple grant mechanism, a direct contribution to housing that is produced in a market context, limited programme administration, and no on-going financial or other risk exposure for government sponsors. It is also effective and has produced affordable ownership housing; however, projects are slower to develop than pure market housing because most are delivered by non-profit groups that have more limited financial resources (lower risk tolerance), more limited access to land and must pre-sell a high proportion of units prior to entering into construction.

There has as yet been no published overall value for money assessment of the scheme. However, assessment of similar projects in Canada suggests that income targets are achieved; that a majority of buyers have higher than expected down-payment contributions, and reduce their exposure very quickly; and that many buyers remain in the units for longer than five years.

There is not, as noted above, any clear sense of the potential 'volume' of the scheme. Volume potential is limited by grant availability, land availability, construction costs and prevailing market conditions. In addition, competition for appropriately located land and construction services make it more challenging to meet affordability targets. This tends to push production to smaller units, limiting opportunities for larger families. A graduated grant by size of unit may be more appropriate.

In large urban markets there is a significant unmet demand for affordable housing in all tenure forms. Particular groups attracted to the AHP home-ownership initiative seem to be single households, large families and younger households. Federal government, as it now switches priorities from stimulus spending to deficit reduction, has already reduced its programme contribution. However some provinces and territories are seeking ways in which to promote the mechanism from within their own resources, for example, a new strategy for the Yukon is likely to place emphasis on a revolving fund of 'silent mortgages'.

USA: the Low Income Housing Tax Credit (LIHTC)

The LIHTC cannot in itself be regarded as a recent innovation. It has also been widely reviewed, both before and after the GFC. It is a large-scale and significant programme (but by no means the overall largest component of US housing policy support). There is a consensus in the literature that its existence encourages other innovations in financing, design and project delivery. We also note that at least three other countries have assessed LIHTC, the UK, Canada and Australia, where LIHTC informed the development of NRAS. In short there are long-term properties of LIHTC that appear positive, not least its 'survivor' politics, and that other countries may seek to emulate it but without adopting all of the quite complex apparatus surrounding LIHTC.

The essential innovation of the LIHTC was that

> Unlike previous supply-side programs, which have directly provided or subsidized low-income housing, the LIHTC program provides tax credits to housing developers who then sell the credits to investors in exchange for equity finance. Investors subsequently claim the credits on their tax returns, making the investor a beneficiary of the LIH credits, in addition to the housing developer or the targeted beneficiary of the subsidized service.
> Desai *et al.*, 2011

The main features of the LIHTC are that:

- It is a federally capped tax expenditure, which provides tax credits (reliefs) that investors in affordable rental housing (that meets programme requirements) can use to offset their federal income taxes.
- Its aim is to assist low and moderate income households, essentially households with an income below 60 per cent of the (equivalised) family incomes of households within a given area or region.
- Maximum affordable rent is defined as 30 per cent of income: rents have to be set at affordable levels and properties let to tenants below the income maximums for a period of 30 years.
- The supply of credits, set by the US Treasury (which controls the programme), are then allocated to states so that local strategic priorities dominate spending. States allocate the supply of credits, usually through a competitive allocation process, to developers and they then sell the credits, through syndicators, to investors who use them to offset tax bills.
- The price paid for a tax credit depends on supply and demand conditions in the tax credit market. In its early phases, when investors still had a perception of high risk, the price of tax credits was relatively low but it improved significantly and peaked just prior to the GFC. Recent, post 2011, evidence suggests that credit prices have now improved to earlier higher (below peak) levels.

- Developers use the funds received to construct units with the investor owning a share equal to the equity invested from the tax credit sale to them.
- For-profit companies investing gain an additional tax advantage, as they may deduct their share of tax losses on the housing project from their other income tax. Non-profits may also be involved as there is a legal requirement that at least 10 per cent of credits are set aside for their use: as in the case of NRAS in Australia, the share of the programme taken up by non-profits is relatively large and has run between a quarter and a third of credits over the life of the programme.
- The value of the credits for a new building is 70 per cent of eligible construction costs (though exceptions are made in some high cost cities and for particular needs groups). There are significant penalties for failing to let houses within the income and rent compliance requirements.

How does the credit work?

When the credits are allocated to states they have considerable discretion, within very broad federal guidelines, to select priorities and projects to support. Some developers use the tax credits to reduce their tax bills and others sell their credits to investors in exchange for equity to fund the construction of low-income housing. This has promoted the development of limited partnership between investors and developers. Desai *et al*., 2011 moot 'For investors who are the limited partners in the transactions, the return is generally from the tax credits rather than income from the project.' (p. 3)

Steele (2006) describes how the credit operates for non-profits.

> The non-profit developer determines whether, at the permitted rents and costs for the site and for construction, a project receiving tax credits is feasible. The developer will need to find a site, estimate the cost of new construction or substantial rehabilitation and determine whether: at the required rents, there is sufficient demand for their proposed housing units; syndicator is willing to sell the credits they might receive, and the price the credits are expected to fetch is high enough. The syndicator's fees and the price of the credits determine the infusion of funds for the project from the tax credits. A lender, typically a bank, will approve the size of mortgage tentatively required, after taking into account the funds expected from investors buying the credits. The equity from these investors will leave less than half the cost to be financed by a mortgage and other financing. Thus interest costs will be quite low.[6]
>
> Developers generally require the services of syndicators as credits are usually sold to many buyers, each buyer having only a limited amount of income tax to be offset by credits. Furthermore, only those confident of their liability for a substantial number of the tax credits in each of the ten years will find the purchase worthwhile.
>
> Steele, 2006, p. 32.

Outcomes

Major outcomes of the LIHTC are agreed to be that, first, the programme has raised investment in tax credits and has increased substantially over time and that the share of investment from corporations rather than individuals has risen significantly over time (see the Australian concerns in relation to NRAS). It has generated 60,000 to 100,000 affordable housing units per annum since its inception. The housing output produced has been diverse and more dispersed than traditional public housing outputs.

Second, LIHTC was disrupted by the GFC, arguably when outputs were most badly needed, because investor demand from credits fell as banks and financial institutions made losses and as the Federal National Mortgage Association (FNMA) (known as Fannie Mae) and the Government National Mortgage Association (GNMA) were forced, by government, to leave the market (Desai (2011) notes how the Housing and Economic Recovery Act, 2008 (HERA) and American Recovery and reinvestment Act, 2009 (ARRA) stimulated housing output and helped restore tax credit prices post 2009).

Third, it engaged non-profits and for-profit investors and revolved around locally driven strategies with competitive allocation processes; in that regard they are policy efficient. It has stimulated a range of innovative housing investment partnerships. Non-profits, for instance, have been prompted into seeking additional supports to make housing available to the lowest income groups and in this sector are widely regarded to have increased output and innovation. Overall, the programme has involved a wide range of actors and interest groups and in consequence has been able to command political support across the spectrum. The programme has real political durability.

Major reservations have been threefold. First, LIHTC essentially provides new rental housing and it is not clear that new homes are the most efficient way of providing homes for the poor. Second, LIHTC does not reach a significant share of the lowest income groups or, by implication, the poorest neighbourhoods. However, it is the absence of complementary funding that prevents low income delivery. Third, the process costs are relatively high, for instance syndication costs, and this reduces affordable housing output. These limitations have substance but the widespread practitioner and policy maker view is that the LIHTC is an effective and essentially efficient programme that rightly lies at the core of national housing policies and local actions.

Implications for the UK

What are the main lessons from this chapter for the UK? First, the models each represent different configurations of local and national interventions within federal systems of governance. The UK's devolved system of government, with housing devolved but with tax and benefits reserved, is both similar but also different in important specifics. Transferring policies that rely on the incentive structures and complex federal–state fiscal relationships – has to be thought through carefully.

Second, the Australian NRAS scheme combines scale, competition between different kinds of providers and encourages the blending of different sources of support, including private sector funds. It is not providing homes for the poorest in society but is playing an important affordable role for moderate-income households and is contributing to place development. In contrast to emerging policies for England, where the emergence of an 80 per cent (of market rents) sector is likely to mean a reduction in the scale of more deeply subsidised social rental housing, NRAS has complemented an expanding programme of social housing provision in Australia.

There are aspects of NRAS, such as the way it encourages competition between for-profit and non-profit providers that are transferable and could be used to improve the somewhat limited efforts to introduce such elements into affordable housing policies in the different parts of the UK. A critical role for not-for-profit providers is as a management contractor. The NRAS example indicates that it is not necessary for such opportunities to diversify income (and indirectly support affordable supply by generating internal surpluses) to require long-term and relatively inflexible business models for this benefit to occur.

Third, the Canadian model targeted at supporting home ownership through a second mortgage, is more modest. In its own terms it is, however, well-designed, transparent, simple, encourages contestable supply between different types of providers. Unlike NRAS, it is not a 'fund and forget' mechanism. The scheme may produce moderate housing quality outcomes, but the repayable nature of the support means that a revolving fund exists for the future. Given the nature of home ownership entry pressures in many UK markets there is little doubt that this simple and transparent approach has potential for transfer and, in terms of long-run public spending, might be more cost effective than present low-cost home-ownership (LCHO) approaches in the UK.

Fourth, the desirable long-term properties of the LIHTC are worth considering further. It has generated large volumes of affordable housing through the use of tax credits and the tax code, providing incentives to private investors to support local level affordable housing. It was adversely affected by the GFC, but is overcoming these difficulties. The LIHTC has promoted contestability between different types of providers and supported different forms of innovative partnerships, including other sources of funds. It has also, however, generated a wide array of affordable and social housing units. It has limitations, but even so the LIHTC's record demonstrates its wider effectiveness. The major barrier to the spread of the LIHTC to the UK is the reality that most of these policy targets are already met by the existing structure of rental programmes. LIHTC is only likely to be a UK policy innovation, were there to be a full, large-scale review of all housing subsidy policy and this does not seem a likely prospect at present.

5 EUROPE

Overview

Europe exhibits a wide range of housing systems. Social rented housing is most prevalent in north-west Europe and Scandinavia, although it is delivered through a variety of landlord models, and tends to provide more of a 'wider affordability' role than the 'safety net' role that is now prevalent in the UK (Stephens *et al.*, 2002). This reflects the higher levels of poverty and inequality in the UK. Even in countries without strong traditions of social rental housing, it is not uncommon to find subsidised house building programmes.

This chapter examines seven programmes in five countries that were selected from an initial list of 26 drawn from ten countries. They were chosen as having been successful in increasing the supply of affordable housing, and offering new ideas that might be transferable to the UK.

Spain's Vivienda de Proteccion Oficial (VPO) programme[7]

Context

Spain has one of the highest levels of owner-occupation in Europe, and very little social housing of the type that is found in north-west Europe. Recent housing history has been characterised by the big housing boom and bust. In contrast to the UK this involved a building boom and bust as well as volatility of prices and transactions.

Although the tradition of social rented housing is weak, there is a very strong tradition of the state promoting house building. In the Franco era a system of sector-specific publicly-owned banks funnelled privileged finance into favoured sectors, including housing (through the state mortgage bank). The cost of finance was lowered by the use of compulsory investment ratios that obliged private banks to invest a proportion of their funds in specific projects at administratively-set rates of return. This system survived into the democratic era, but was wound down in the 1980s and 1990s as the banking system was deregulated and the state-owned banks were merged and privatised.

Spain's VPO (literally 'officially protected housing') programmes have been the mainstay of the country's affordable housing programme since democracy (and even then were modelled on Franco-era predecessors). Since 1978, VPO has added more than 3 million units to the stock. The schemes provide a subsidy to the developer (private, public, union, etc.), which is then passed on, usually in the form of a mortgage, to the resident on a means-tested basis. A rental version also operates. It is the combination of supply-side subsidy, which is then targeted into a demand-side subsidy, that is interesting for the UK.

Description

The VPO programme has always had the twin objectives of stimulating economic activity through the construction industry and improving housing affordability. The second of these objectives is promoted in two ways: first by increasing the supply of housing generally and second by providing greater subsidies for people on lower incomes. However, around 80 per cent of the population would in principle qualify for some form of VPO housing.

The home-ownership element is the largest and most well-established part of the VPO scheme. The key subsidy is cheap land, which is usually provided by the municipality. Developers tender to build a certain number of houses on the site. However, the benefit of the lower land price is diminished somewhat by the obligation to purchase parking and storing space from the developer, and these are not subsidised. The development is financed by a mixture of deposits from prospective purchasers (20 per cent) and banks. Individual purchasers may gain a subsidy for the down payment, which varies according to income (inversely) and number of children. Purchasers are normally selected by the developer using lists of eligible households provided by the municipality. However, since around 80 per cent of the population is eligible for basic VPO housing, developers have much freedom and exercise it to house better-off households, especially on developments in expensive areas. It is the division of the loan taken out by the developer among the purchasers that provides the crucial link between the supply- and demand-side subsidy. Purchasers may qualify for additional subsidies, again varying according to income and number of children. VPO housing may be resold at any time without the loss of the subsidy embedded in the land, but the other subsidies musts be returned in full if the property is sold within ten years. After 20 years, there is no obligation to return any subsidy.

A rental version of VPO exists in which land is also the most significant subsidy, although it is merely leased. A subsidised loan replaces the prospective purchasers' down payments in the ownership model, while targeted loan subsidies vary according to income. For private developments rents are slightly below market levels. The municipality plays a greater role in the selection of tenants than in the case with the ownership model, with more narrowly specified lists of eligible households.

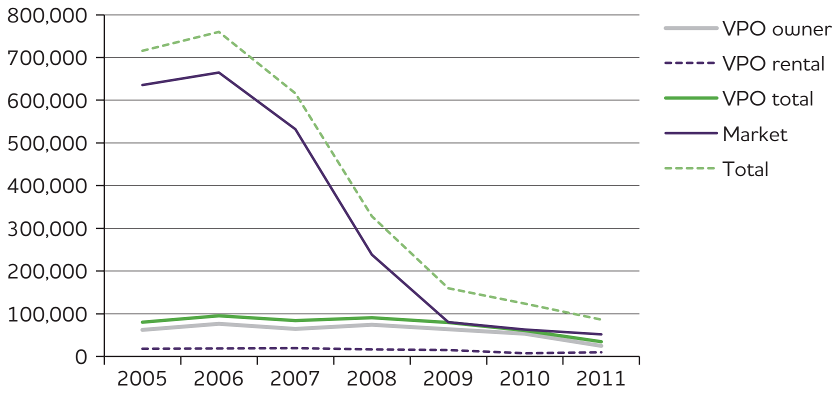
Analysis

VPO is tried and tested over decades, and in that sense has been robust. It has adapted according to changing circumstances. The emphasis used to be on interest rate subsidy, but this has shifted towards more general price/rent reductions and assistance with deposits. The emphasis has also shifted away from merely increasing housing supply, to targeting subsidies according to income. It is this combination of supply-side subsidy with subsidy that is in some ways targeted that is attractive from a British perspective.

This flexibility may also account for the way in which VPO housing is not 'ghettoised' – either in terms of residents, location or physical standards (which are often higher than those applied in open-market housing).

However, as the system has shifted away from the provision of privileged credit delivered through a highly regulated financial system to one where subsidies are more explicit, and finance raised within the context of a liberalised finance system, the scheme has lost its countercyclical character. If private finance cannot be raised, VPO suffers a rapid decline, as is the case now (see Figure 1).

Figure 1: Housing starts (2005–11)



Source: Country expert

It is also vulnerable to the combination of administratively set prices within the context of one of Europe's most volatile housing markets. Administratively set interest rates in the 1990s became unviable, when market rates fell way below these following Spain's exit from the European exchange rate mechanism. This promoted the change in subsidy structure. At present administratively set prices are higher than market prices in eleven regions. Overall, the price of VPO housing has fallen from around half that of market housing at the peak of the boom (2007) to around 30 per cent in 2012.

The model is relatively straightforward, although not very transparent – it is difficult to tell exactly how much subsidy there is, and the split between the developer and the occupier. Similarly it is not easy to judge whether the scheme represents value for money. This would also depend on the cost of alternative schemes that do not exist. However, Spanish housing policy overall costs a low proportion of GDP (although it is not clear whether all the subsidies attached to VPO are measured in this), and housing output has been high. The scheme is likely to have second-order effects of lowering prices generally, due to increasing supply – although such impacts are difficult to detect in the severe boom/bust cycle that Spain is experiencing.

In summary, VPO has been a large-scale programme, founded on a high level of private sector appetite. VPO provides a shallow – though variable – subsidy, now primarily in the form of land. While not targeted at the poorest, subsidies have become more targeted over time.

Denmark's national building fund[8]

Context

At around 20 per cent, Denmark has a similar-sized social rented sector to that of the UK. Almost all social rented housing is supplied by housing associations, which are characterised by high levels of tenant control at the estate level.

The basic funding model is similar to that which was adopted in the UK in the late 1980s. New housing is financed in part by a capital grant (typically 14 per cent), but mostly by a private sector loan (typically 84 per cent). There are three important differences, however. First, a small tenant contribution (2 per cent) is required. Second, the municipality guarantees the loan; and third, there is also a revenue subsidy paid in the earlier years of the loan to smooth out rental payments.

An important contextual difference is that Denmark has one of the lowest levels of income poverty and inequality in Europe, and related to this, housing associations house a broader section of the population than is the case in the UK.

Denmark's social rented sector shares another important similarity to the UK's. It is relatively mature, and is therefore tending to generate surpluses. England has experienced 20 years of controversy with the treatment of HRA surpluses which has been resolved, at least for the time being, with the redistribution of housing debt as a one-off (though probably not final) settlement.

The existence of a housing association 'building fund' in Denmark is therefore of great interest. Having been established in the 1960s, they have a history, and may provide some clues as to whether they could play a role in the UK as a means of ensuring investment in the social sector, including for new housing.

Description

The National Fund for Non-Profit Housing Associations (*Landsbyggefonden* (LBF)) was established in 1967 to equalise rents between properties with different underlying debt profiles, but has since grown to promote the financial autonomy of third sector housing. Its day-to-day governance is the responsibility of a nine-member board, which includes representatives of the housing associations, tenants and the two largest municipalities. Its independence is limited as its budget has to be approved by the responsible government minister.

Contributions are made as part of the rent to reduce anomalies arising from underlying debt profiles of estates. Additional contributions arise from rents collected from debt-free properties. For properties built before 1999, two-thirds of the surplus goes to the LBF; for those built afterwards all surpluses between the thirtieth and thirty-sixth year are captured and then they are divided evenly between three accounts. One of these counts is used to pay for the modernisation of dwellings; another to support area regeneration; and a third is intended to support new build. However, it is not expected to start to receive funds in any volume until around 2013.

In principle, the Danish system offers a mechanism for 'revolving door' finance. However, the fund intended for regeneration was effectively run-down in the 2000s to compensate for reductions in government subsidy for new build. New build is financed by a mixture of a mortgage, a capital grant and a small tenant contribution. A revenue subsidy from central government has also helped to ease costs in the early years of a development. The government cut this contribution dramatically after 2002, with the balance being made up from the LBF (see Table 1). However, the funds have been accounted for until 2018–20, confirming that the policy was of limited sustainability.

Analysis

LBF is more than a 'revolving door' mechanism. In principle, it is attempting to act as a national rent pool to even out rents between new and old properties, as a reserve for long-term renovation and increasingly as a source of development finance to replace government subsidy. However, the latter had limits as the account was run down in a few years.

The experience suggests that ultimately there is no way of preventing governments cutting subsidies to housing, and it is not absolutely clear whether the existence of LBF facilitated a cut in subsidy, or whether it

Table 1: Financial conditions for third sector housing development in Denmark

% of construction price	Tenants' contri-bution	Capital grant: State	Capital grant: Local Govern-ment	Capital grant: LBF	Realcredit/ Danish mortgage	Support for running expenses/keeping up mortgage loan: State	Support for running expenses/keeping up mortgage loan: Local Govern-ment	Support for running expenses/keeping up mortgage loan: LBF
Nominal loans								
01.01.1999	2		14		84	100		
15.06.2001	2		7		91	199		
01.01.2002	2		7		91	29–47		53–71
01.01.2005	2		7		91	50		50
01.01.2007	2		14		84	75		25
01.01.2010	2		14		84	75		25

protected the sector from a cut in subsidy that would have happened anyway – or something in between.

Figure 2 suggests that it is not straightforward to read too much into the levels of third sector approvals. The collapse in 2007 was due to costs rising above a maximum, and levels recovered rapidly after that.

Interestingly, the fund has not prevented housing from being highly politicised. The use of funds to support construction was deeply opposed by tenants' organisations and by left-wing political parties, in much the same way that using HRA surpluses to pay for housing allowances was controversial in England.

Nonetheless, the Danish system keeps initial subsidy *within* the social housing system, and has been used to limit future taxpayer commitment. In some respects the fund also marks a good deal of continuity in housing policy. The fund has existed for 45 years, and the establishment of the construction element after 1998 implies looking forward for a similar period. In principle the fund is a model of sustainability – with a maturing sector providing funds for renovation and new build. The fund was run down very quickly, however, when the government chose to do so. Even if government is excluded from the operation of a similar fund, it is difficult to see how the government cannot in effect force it to be run down (by cutting subsidy).

Figure 2: Approvals for construction 2000–10

It is interesting to note that in Denmark the funds are judged to lack transparency and simplicity. The incorporation of several objectives into the funds may have contributed to the complexity. It is possible that a fund operating on the same principles could be designed to be more transparent and simpler.

In summary, the idea of a building fund to capture sector surpluses is a mechanism that has to be built up over many years. Then it is capable of complementing, not fully replacing, government subsidy – otherwise it will be run down quite quickly. The fund is not especially geared towards levering in private finance, but does contribute to mainstream social rented housing.

Ireland's Rental Accommodation Scheme (RAS)[9]

Context

Ireland has one of the highest levels of home-ownership in Europe. The promotion of home-ownership has been still more vigorous than in the UK. The most recent housing market cycle has been more violent than in the UK, and, as in Spain, was combined with a house building boom and bust.

The social rented sector is somewhat smaller than in the UK. Consequently, the private rented sector plays a vital role in housing low-income households. Small-scale amateur landlords dominate this sector, as in the UK. The Irish housing allowance operates in a somewhat different way to in the UK. Known as 'rent supplement' (RS) it is limited to unemployed private sector tenants. Thus it is only an 'out-of-work' benefit in contrast to UK Housing Benefit which is both an in-work and out-of-work benefit. The RAS was a response to rising costs of RS. Since costs per claimant rose, there was evidence that RS inflated rents. It was also felt that the private rented sector was offering a poor deal for some tenants in terms of quality and location; and the structure of RS was also believed to deter employment (since eligibility ends abruptly if a claimant gets a job). The RAS was piloted in 2005/6.

Description

The RAS applies to unemployed people who live in the private rental sector and have received RS for 18 months, that is, are long-term unemployed. At this point, the local authority reviews the case and inspects the accommodation. If its quality is adequate, and the landlord is willing to co-operate, the tenant may be transferred into the RAS scheme *in situ*. If the quality is not high enough, or the landlord does not wish to participate then the local authority seeks alternative suitable accommodation in the local authority, housing association or private sector.

In the case of the private sector, the local authority aims to negotiate an agreement with a private landlord to lease the accommodation for up to ten years in return for a discounted rent, which is 8 per cent lower than the market rate. In return the local authority takes responsibility for letting the property and collecting the rent. If the property becomes void, the local authority still pays the rent. The landlord retains responsibility for maintenance. Rent reviews are built into the lease, as are arrangements for ending it.

Meanwhile the tenant no longer receives RS. Instead they pay a contribution to the rent that varies inversely with income. This is calculated in the same way as differential rents in the local authority sector. This feature ends the 'cliff edge' of immediate cessation of rent assistance should the tenant gain employment. The scheme is financed by central government, but savings are ring fenced and used to finance social housing.

Analysis

A key test of RAS is whether it is able to deliver private rented accommodation of an acceptable quality more cheaply than is the case with tenants agreeing contracts and receiving RS. A 2009 study (DoEHLG, 2009) found that market rents on RAS properties of a similar size were let significantly below market rents in the vast majority of cases. This was especially notable in Dublin – and within Dublin the greatest savings were on larger properties – 31 per cent on three- or four-bedroom properties compared to 12–18 per cent on one- and two-bedroom properties. Where properties were let at above market rents this was attributable to the lack of supply of certain property types – for example, small properties in rural areas.

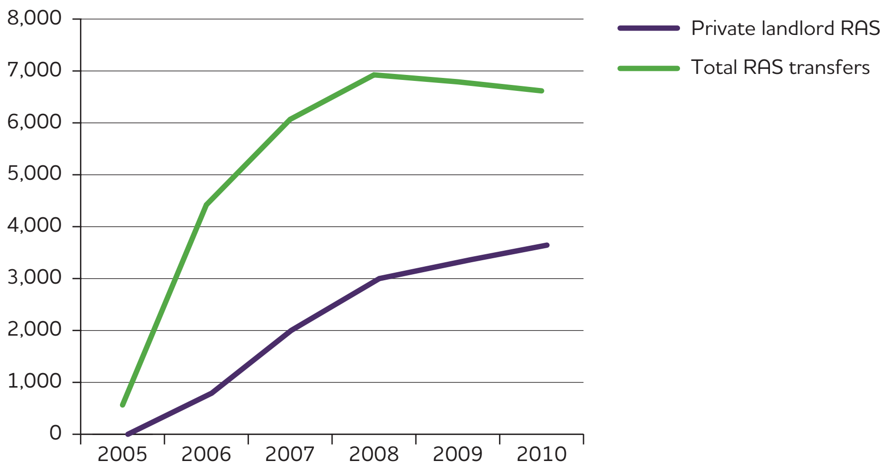
The most comprehensive analysis suggested that rents were higher on RAS properties compared to RS properties of a similar size, but that the difference was attributable to higher quality (Coates and Silke, 2011). The study found that the net present cost of providing RAS properties over a 20-year period is significantly cheaper than RS in the vast majority of cases. The savings are greatest for larger properties (that is, those with three or more bedrooms) and outside cities. This finding was predicated on there being no major change to RS during this period.

Compared to social rented housing, RAS may be more cost effective, since tenancies are not for life – although they also provide greater security than is the case in the private rented sector outside the scheme. The better quality and security attributes of RAS housing compared to the rest of the private rented sector are suggestive of good value for money. The scheme may also have the effect of lowering rents more general in the private rented sector, although this has not been shown to be the case.

The key to the scheme's success lies in the ability of local authority staff to negotiate rents with private landlords. Such skills are not common in the public sector. In the Irish case, consideration was given to providing financial incentives to local authorities to be effective in negotiating rents by allowing them to keep a share of the savings. However, this was dropped on grounds of complexity.

In summary, the scheme has facilitated better value for money for the government, while generally providing a better deal for private tenants. The scheme depends on private sector buy-in, which has clearly been achieved – see Figure 3. The scheme is well-targeted on lower income households, the main disadvantage being that it does not directly contribute to increasing supply overall. However, it was not designed to do this.

Figure 3: RAS Outputs (end 2005–end 2010)



Source: Department of Public Expenditure and Reform (2011)

The Dutch guarantee fund and central funds[10]

Context

Around one-third of households in the Netherlands live in housing association properties, making it the largest social rented sector in Europe. It is the legacy of a large state-sponsored social building programme. However, as in many other countries, once the large shortages in housing had been met, the state looked for ways in which it could reduce its involvement in housing. In 1995 housing associations were given financial autonomy when the state effectively wrote off outstanding debt in return for no further subsidies.

Financial autonomy was built on two institutions that were established in the 1980s: the Central Fund for Social Housing (CFV); and the Guarantee Fund for Social Housing (WSW). CFV is the first defence against financial difficulties by supervising the sector and supporting housing associations that become financially distressed. The second line of defence is WSW, which guarantees housing association loans. The third and final line of defence is the government.

Description

WSW is a guarantee fund established in 1983, with the status of a private foundation. Housing associations seeking private finance to fund a development (new buildings or renovation of existing ones) are subject to a number of checks by WSW. These include a financial check to ensure that the dwellings will yield sufficient rental income to repay the loan, and that the dwellings are of sufficient technical quality. A minimum solvency requirement of 5 per cent is needed when loans are sought to fund new housing or property acquisitions. Housing associations also pay a fee to WSW connected to each loan that is guaranteed. Until recently the municipality had to agree to act as a backstop for each loan relating to investment within its boundaries. However, there has been a tendency to move away from project-specific guarantees towards generic ones. In turn this has led to the withdrawal of municipalities from guaranteeing new loans (since 2010). However, they continue to act as guarantors on loans taken out before 2010.

WSW guarantees some €85 billion of loans (£71.162 billion)[11] and has a reserve of €85 billion (2010). Its annual operating costs were about €9 million (or £7.5 million) in 2010. There have been no claims on WSW in its (almost) 30-year history although the largest housing association, Vestia triggered a crisis when treasury management associated with interest rate swaps went badly wrong.[12] The government guarantees are treated as state aids.

WSW delivers triple A ratings for housing association loans that are guaranteed through it, and it claims that this translates into monthly rents that are €35 (£29.30) lower than they would otherwise be.

CFV is a public body, established in 1988, that supervises housing associations and produces annual reports on every housing association in the Netherlands. Clearly the supervisory role is intended to reduce the risk that a housing association might encounter financial difficulties. However, CSV can intervene in two types of situation: (a) where there is a cost over-run in a particular project that causes financial distress; and (b) where there is a general financial problem that threatens the viability of a housing association.

Direct financial assistance in the form of interest-free loans or subsidies is relatively uncommon and has occurred only twice since 1983. More commonly CFV facilitates re-organisations, especially mergers between weaker and stronger housing associations. Such interventions have occurred 18 times since 1983. The most common model is that the financially strong housing association takes over the financially troubled one.

The procedure can be quite protracted. Before a housing association can receive support from CFV it must demonstrate that it has done everything possible to resolve its problems and explored alternative solutions. It needs to consult with third parties, including WSW and municipalities, whose approval is required in the event of a large-scale merger.

Fees from its members fund CFV. In 2011, CFV had a reorganisation fund of ca. €118 million (£98.79 million) and provided a loan of €39 million (£32.65 million) to facilitate the merger of a weak housing association with one judged to be stronger. Its fee income was ca. €56 million (£46.88 million). Operating costs were € 7 million (£5.86 million).

Analysis

WSW and CFV provide relatively simple products that appear to have worked well over a long period of time. Although the state acts as a backstop in the case of WSW, both mechanisms have acted in the spirit of 'solidarity' within the housing association sector. So far housing associations are bound together in a common interest to protect their triple A ratings that facilitates access to low cost funds.

In summary the Dutch funds represent mechanisms that were introduced into a maturing social sector. They are (more or less) universal, facilitate private sector appetite in the housing association sector, which continues to house a relatively broad range of households.

The German use of tax incentives for private landlords[13]

Context

Germany has the lowest level of home-ownership in the European Union and the largest private rented sector. Its housing market is also remarkably stable, as is the policy context. Like many other countries, Germany embarked on a large-scale building programme in the 1950s, but unusually social renting was defined by the receipt of subsidy rather than by provider. Thus private landlords have been among the many providers of 'social' rented housing, this status placing restrictions on whom can be housed and the rents that can be charged for the duration of a subsidised loan. Once this has been repaid, the housing ceases to be 'social' rented, and instead becomes 'private' rented. This phenomenon accounts for the decline of the 'social' rented sector, which is now below 5 per cent of the stock, and is continuing to decline.

The German private rented sector has been regarded as a successful stabilising force, and a means of making the housing market as a whole more affordable. Even the segment without bricks-and-mortar subsidy brings with it security and second-generation rent controls. The sector has benefited from three principal tax privileges: a degenerative depreciation allowance until 2005 (since when it has been linear); the ability to set losses against other income ('negative gearing'); and capital gains tax exemption for properties held for more than ten years

Description

The depreciation allowance for newly built houses was introduced in 1949 with the aim of increasing supply at a time of acute shortage. Until 2005, the allowance was designed to be 'degenerative', so the initial allowance was reduced over time, so bringing the benefits forward. The allowance rates were subject to frequent adjustment (and indeed were withdrawn for several years in the 1970s). The depreciation allowance is applied to the building costs (or value) of the property *excluding* the value of the land. The cash flow is taken to be the rent less mortgage interest payments. The depreciation allowance (that is, percentage of the building value) is deducted from the cash flow, and has the effect of reducing the landlord's tax liability at their marginal tax rate. In the early years, the depreciation allowance could have the effect of making the tax liability negative. After 2005, the 'degenerative' depreciation allowance was replaced with a linear allowance (set at 2 per cent, or 2.5 per cent for old buildings), that is, one whose rate remains the same

Analysis

It is difficult to assess the extent of the impact of the tax regime on the supply of new private rented housing. The number of new private rented dwellings completed without 'social' subsidy in Western Germany between 1960 and 1995 has been estimated at 6 million, representing 2.8 per 1,000 inhabitants over the whole period. Nor is there a straightforward relationship between the tax system and supply. For example, supply continued to fall after the depreciation allowance was reintroduced in 1978 (having been suspended in 1973). Certainly, the tax incentives should have contributed to new supply, but the extent to which they fed through into new supply or lower rents would depend on the relative price responsiveness of supply and demand. Moreover, the combination of degenerative depreciation allowance and negative gearing was justified, in part, as compensation for rent regulation and security of tenure.

A powerful argument against tax incentives such as these is that they are regressive and poorly targeted. The better off will tend to benefit from them as landlords. Similarly, quite well off tenants will also benefit. The core issue seems to be that the system could be justified in the 1950s when Germany faced a huge housing shortage, but it would be much harder to justify today, except in so far as they are needed to counteract the disincentives arising from rent regulation and tenure security. Where regional or local housing shortages exist, supply might be more effectively encouraged by subsidy instruments that can be better targeted, such as grants.

In summary, the tax treatment of private landlords in Germany has been part of a housing policy geared towards a strong supply side that has arguably limited the need for large-scale direct provision by the state. In doing so it has not been targeted, and forms part of a long-term strategy.

Implications for the UK

The five case studies raise a number of issues for UK innovation in the financing of affordable housing supply.

- The Spanish VPO scheme, long-established, has shifted away from merely increasing housing supply, to targeting subsidies according to income. It is this combination of supply and demand-side subsidies that is attractive from a British perspective. It is flexible (though not completely transparent) but has suffered in the recent downturn as a result of losing its counter-cyclical quality (as it is now more reliant on private sector input) and is vulnerable to house price risk. The scheme is, however, readily transferable (it would not require new institutional infrastructure) and could support construction stimulus activity.

- The Danish housing association surplus building fund is a well-established programme operating in a relatively similar model to post-1988 UK housing associations. There are institutional governance and autonomy issues to resolve over how any such fund is managed – but nothing insurmountable. Denmark's case shows that internal funds can replace scarce public subsidy for construction and that there can be indirect ownership over fund disposition. A more transparent scheme perhaps with limited contributions could be allowed to build up something useful for the UK or devolved context and could be a revolving fund.

- Irish long lease (RAS) properties appear to offer quality-adjusted lower rents than the market and are cost-effective in that the leases, while longer than market tenancies, remain shorter than average social tenure tenancies. There are local versions of long leases in the UK, particularly in Scotland as part of the arrangements for implanting its homelessness legislation, but it is not clear that the negotiated lower rents have been achieved on anything like the same scale. Of course the RAS scheme does not increase the supply of new housing, but does increase the quantity and quality of housing available for social purposes.

- Concerning the Dutch guarantee and funds, we argued above that the housing association sector has historically achieved similar credit ratings, scale and access to funds without the need for these formal mechanisms. However, as we have argued elsewhere in this report, there is a sense of a creeping move slowly towards key elements of the Dutch system, again highlighted by the recent announcement guaranteeing £10 billion of social housing investment. It is also not clear that the major developing housing associations are convinced of the virtues of Dutch 'solidarity'.

- German tax advantages may be an important reason for the much envied long-term stability of the German housing system. However, while some of the principles could be applied, the German principles of taxation look quite different institutionally, the tax incentives are not necessarily well-targeted and other forms of effective subsidy may remain more effective in a UK context. Nonetheless, the German case does suggest that there is merit in considering tax incentives, especially if they can be traded-off with greater tenure security or longer leases. There are obvious links to the Irish long lease model discussed earlier.

6 THE UNITED KINGDOM

Overview

Determining the UK policies is not straightforward. Further pragmatic decisions have to be made about eligibility. First, there are existing policies that are in place and will expand affordable supply but have limited transferability or are restricted by financial capacity (for example, the AHP). Second, there are policies operating comparatively successfully in one jurisdiction that would not work in another (for example, Scottish council building with grants and prudential loans would be inhibited by borrowing caps in England). Third, there is divergence between different party political outlooks across the UK, albeit one functioning within a shared broad housing system, and economic and fiscal context.

Below, we set out a number of policies actively being discussed or in place that have potential for cross-fertilisation from one part of the UK to another, policies that could augment affordable supply across the housing system. Thus, we combine actual policies with others that are still to be established. We have also grouped a further set of related policies under one heading. Even if they do not all 'work' according to our criteria, there may still be the elements of a given idea worth pursuing.

The UK material reflects the current and likely future fiscal context and is also sensitive to devolved arrangements. In that sense it is closer to attempting to work with the present system than, as we saw earlier with the proposals from IPPR and Policy Exchange, proposing reforms that mean upturning large parts of the system. Nonetheless, we do return in the final chapter to the bigger picture of wider housing system failure and long-term policy development.

The starting point is the search for more affordable supply, where capital subsidy is substantially reduced (and may be entirely eliminated in the future), borrowing capacity is limited, and both banking regulation and balance sheet restructuring are adversely affecting the terms and conditions of lending, but where, at the same time, rents on new affordable supply will be constrained by the reform of housing benefit. Moreover, the increased use of capital markets is also not unlimited – NHF (2012) point out that there is a small number of institutions who purchase social provider bonds, but their long-term demand is unclear and there will be competition in the future from councils (let alone uncertainty created by wider global financial concerns). Partnerships with the private sector and other parties will combine to raise the necessary capital through debt and in some cases equity to make the risks, returns and governance acceptable such as to generate the affordable supply. In what follows, we look at models and financing innovations that would allow this balancing act to be achieved, though we also consider innovations with respect to low cost home ownership.

Social real estate investment trusts (REITs)

Description and background

Real estate investment trusts (REITs) are financial entities organised to provide a tax-transparent way of investing in real property. Established in 2007 in the UK, and provided that the trust is primarily involved in the business of renting housing (at least 90 per cent of rental profits is returned to shareholders), a residential REIT may provide an efficient route for institutions to invest in rented housing (since the REIT is thereby exempt from corporation tax which acts as an incentive to the tax-exempt institutions – see NHF, 2012, p.3). Yet, to date, this has not happened and, instead, REITs in the UK have typically emerged from the conversion of existing property businesses. Financial institutions have been unable to find the scale of business they want, nor the necessary returns (known as the yield gap).

REITs have attractions to the social and affordable sector both in terms of raising funds (and funds that can be recycled) and in providing a management contract and continuing ownership interest (depending on how the REIT is structured). Many from the sector have argued that the management expertise and scale economies offered make them an obvious partner for private investors. There is a strong 'sale and leaseback' theme to this investment model. In 2007 a number of major associations did try to initiate an HA REIT, proposing a £259 million investment and opening discussion with the private sector – but it did not go forward (NHF, 2012).

Earlier in 2012, HM Treasury announced a consultation which would investigate the scope for a social (more accurately an affordable housing) REIT which hoped to draw on the scale economies of the housing association sector, index-linked rents, the security of housing benefit and low rent arrears to (perhaps) provide a sufficient return that might tempt the institutions. At the same time, associations, having sold properties into a REIT and thereby accessing funds to build more social or affordable housing, might expect to hold the management contract for the REIT properties.

NHF (2012) sets outs two variants on the social REIT model:

- Housing associations sell part of their existing stock to a stock exchange listed company (the REIT) who in turn raise more capital from investors. The subscription funds could either repay the associations or buy further tranches of stock from them. The social landlords are likely to retain the management contract and/or a significant equity stake in the REIT, which would provide ongoing income and allow a degree of control over the management of the property.
- In evidence to the DCLG select committee (HCCLG, 2012), Places for People suggested an alternative mode. Initially, the REIT purchases 5,000 existing rented properties from the social landlord. The funds thus generated by the sale would be used to finance additional new development in affordable and market rented categories, and once occupied these would be sold into the REIT – and this process could be repeated several times.

Analysis

Perhaps the critical question is whether or not these new vehicles will generate returns that can overcome the yield gap that appears to exist. NHF (2012), following Williams *et al.* (2011) and the DCLG Select Committee report (HCCLG, 2012) observe that institutions typically require a 7 per cent yield on their investment but returns performance for residential investment in England has averaged only 3.5 per cent. However:

> recent volatility in the financial markets and diminished opportunities for such a high level of return on investment has resulted in an increased appetite for lower yield but more secure returns. This includes an interest in long leased properties, preferably with index-linked rent as liability-matching assets.
> Williams *et al.*, 2011, p. 4

HM Treasury shares this belief (see their consultation document). NHF think that if a return of 5–6 per cent can be achieved, that would be sufficient for investors to participate in a social REIT, given management efficiencies, housing benefit and high demand. It remains to be seen whether long-term returns below 7 per cent are genuinely acceptable and under what kinds of conditions. For example, is the working assumption that housing associations will hold management contracts in the long term generally valid when investment fund managers are chasing target returns and could choose to exercise exit clauses?

There are a series of further issues:

- Concerns have been raised about the specific feature of the 90 per cent distribution rule, as housing assets require dedicated or sinking funds for maintenance.
- A similar issue is that the REIT model arguably does not acknowledge sufficiently the holding investment nature as opposed to a trading business. There have been corresponding calls to reform (even abolish) the Stamp Duty Land Tax regime applying to REITs.
- There is uncertainty also about how much appetite the funds have for this type of activity. though it is not limited to them only – what about retail market and individual investors and, for example, the SIPs pension market and ISAs? However, there is no denying the immaturity of a new investment product and the instability of the market.
- A further series of technical governance issues concern grant embedded in the original stock sold to the REIT and the sale of charitable assets into a for-profit company. There will also need to be adequate guarantees to protect both new and existing tenants.
- The supposed income indexation that is commonly seen to be an important feature of the model is not perfect since the assumed uplift in affordable rents is linked to market rents rather than RPI.
- REITs are off balance sheet and involve equity rather than debt and this is promoted as a mechanism that does not weaken borrowing capacity in the way that private debt finance has done through gearing, meeting loan covenants and provision of adequate security (it is the latter that rapidly erodes borrowing capacity according to the NHF (2012)). However, the act of selling property into the REIT will itself affect the landlord gearing calculation, the security they can make available and their lender covenant compliance.
- Looking at the social REIT model it was noted that it resembles a form of sale and leaseback model with a capital sum generated by the initial sale

of assets into the trust (possibly augmented by an equity position in the trust) and the scope for a management contract as a source of revenue. Derwent Living have recently set up such a sale and leaseback model with Aviva calculated on a 50-year lease based on an index-linked 4 per cent annual fee and the properties reverting to Derwent at the end for a nominal sum. For this, they received something of the order of £40–45 million (NHF, 2012). However, while sale and leaseback may work in certain contexts, NHF considers the model to be 'usually on balance sheet, relatively inflexible and slightly more expensive than debt and will still deplete association borrowing capacity' (p. 9).

Social REITs are an unknown quantity – they evidently have several hurdles to negotiate, but if the appetite to invest is genuine there are gains to be made for associations to participate and it would by definition generate additional funds. However, as the disappointing experience of residential REITS since 2007 indicates, it is not clear that the yield gap can be closed, nor that the various governance, scheme design and taxation question marks can be resolved, other than for a few limited special cases. As a footnote – in the autumn of 2012, the Coalition government indicated that, after consultation evidence was reviewed, they would not be promoting the development of social REITs at this time.

Partnership models

Background

A number of partnership models involving different subsidy routes, private sector participation and combinations of affordable and social rent have emerged in recent years. Here, we limit the discussion to three specific examples.

National Housing Trust Initiative (Scotland)

The National Housing Trust initiative (NHT) model emerged as the first substantial output from the Scottish Futures Trust, set up by the first SNP government as a not-for-profit alternative to PFI. In part a solution to unsold partly completed private sector sites, the original NHT model was based on a joint venture between councils and private developers. Funded by loans from the councils, alongside private sector loan finance and equity, this joint venture offers intermediate rented property with starting rents for the first let of each NHT home being set at or below local housing allowance ceilings. After five to ten years the properties will be sold, with the sales proceeds being used to repay loans, recoup any calls on the Scottish government guarantee (see below) and potentially earn a return to the private sector on its equity investment. The principal risks to the council partner – void loss reducing rent and capital loss on resale – are covered by a Scottish government guarantee (typically priced at around £2,500 per unit). The first round of procurement under the original model is delivering over 600 affordable units across Scotland. A second round of procurement is underway and the initiative has also been expanded with the introduction of a version specifically for housing associations, which includes flexibility for participating housing associations to retain stock indefinitely.

National Housing Trust Round 1

The first round of procurement of the original NHT model for councils and private developers is delivering over 600 affordable homes for rent across the following council areas (Scottish Government website):

Aberdeen City	41
City of Edinburgh	422
Falkirk	27
Highland	57
Stirling	16
Borders	51

Although the council loans are for up to ten years and are guaranteed – they do have an impact on overall council borrowing capacity. Thus, there are limits to the extent of this kind of initiative and there will be locations where it would not work, either for mid-market rent demand reasons or because of insufficient borrowing capacity given the other things councils wish to invest in. However, it should also be noted that this type of project enables councils, who have disposed of their landlord function through stock transfer, to become housing providers once more, albeit in partnership with the private sector and the Scottish Futures Trust.

Rettie's Resonance (Scotland)
The Scottish property company Rettie's proprietorial Resonance model is established with several social landlords across Scotland. It works by a developer selling new properties for affordable rent to a social landlord but with land costs deferred till the properties are ultimately sold on after a period of years. The added value is that the social landlord will keep a minority share of the units in perpetuity. The risks to the housing association are reduced, for example, in the Edinburgh-based project by a fixed rental risk contingency provided through City of Edinburgh Council's affordable housing funding and agreed with the Scottish government.

The Rettie's Resonance model in principle

Clarke (2011, pp. 10–11) provides a worked example of the model. The model is based on occupancy risk. For illustration, assume that the developer builds the units and sells them to the Registered Social Landlord (RSL) for £80,000 per unit (deferring the land element which is effectively the investment component for the developer). The RSL funds this with a ten-year loan secured on the future income stream and then lets the properties it now owns at mid-market rent. Critically, the developer retains a call option to sell 13 vacant units (out of 15) over the ten years, whereby sales proceeds generate a return on the deferred land element and repays the RSL's debt on the units sold. Here, two out of 15 units remain in perpetuity with the RSL. Several developers and housing associations are currently pursuing the mechanism with Retties.

Unlike the NHT, where the units must remain available for rent for five years, the Resonance model allows for the private investor to retain the right to reimburse the housing association and sell the homes at any time (subject to existing tenancy agreements). In return for this mechanism, that allows for the early release of capital in this way, a proportion of units are retained by the RSL in perpetuity for no more than the build cost. The permanent affordable nature of these retained units may in fact help persuade otherwise reluctant councils who do not want to pursue the original NHT models for councils and private developers that other models of mid-market rent like Resonance might better meet their local affordable housing requirements (Field *et al*., 2012).

Welsh affordable homes limited liability partnership (Wales)
The Welsh Housing Partnership combines public funding (government grant), support from a number of Welsh housing associations and loans from the Principality building society. An example of the approach, creating special purpose vehicle is the Ely Bridge scheme in Cardiff, which will generate 700 new homes, 400 of which will be at social or affordable rent levels (see box).

Ely Bridge, Cardiff

Ely Bridge is a vacant brown field (contaminated) site, a former paper mill on 56 acres. The project was initiated by Principality building society and would involve 300 units for sale, 300 intermediate rent and 100 for social rent, as well as a school, offices for rent and a riverside park in Cardiff. The affordable housing will be managed by a community-based housing association with rents at or below local housing allowance ceilings. The project would not involve housing grant but does involve cheap public land and a £6 million repayable loan. Instead, its innovative financing and ownership model would be based around a not-for-profit social enterprise company that would develop the site formed as a partnership between the Welsh government and the Principality building society. A repayable loan from the Welsh government's Economic Stimulus Fund will help with decontamination. The proposal would see the company wound up on the final stage of development and the properties transferred into an investment company who would in turn lease the rental component to a social landlord who would manage and insure the properties. Profits on the sale of land for open market sales would be reinvested either in other sites for social/affordable housing or to help increase the volume of the model.

Analysis

These different models have common threads, including:

- partnership between central and/or local government with the private sector, either developers and/or lenders;
- partnership vehicles that may or may not take the operation off balance sheet;
- deferred or subsidised land as a key element of investment by one of the parties (often the public sector but can also be private as in the deferred land cost case of Resonance);
- a large if not completely affordable rent element often linked to local housing allowance levels;
- the use of soft loans, local government loans or full-scale embedded partnership from the mutual lender (as in the case in Wales).

Furthermore, the NHT is linked to state-backed guarantees (central government) which protect the not-for-profit or state partners from occupancy or sales risk while the first Resonance projects in Edinburgh included a fixed rental risk contingency provided through City of Edinburgh Council's affordable housing funding (agreed with Scottish Government).

The key role of housing associations as managers (as is envisaged for phase two of the NHT in Scotland) including their embedded role in local communities where the programmes can be linked to area regeneration efforts, such that the short timescale of intermediate rental and its eventual sell-off, has to be set against the partnership's long-term vision for the area and community.

Finally, while it is the case that most properties will be sold on to help the private sector recoup its investment, this need not be the case, as we saw with the Resonance model – Field *et al.* (2012) found that many of the mid-market rent affordable projects analysed for their evaluation of the Scottish housing Improvement Fund were long-term investments that did not have an 'expiry date'.

A key issue for all mid-market or intermediate affordable rent schemes is underlying demand. Reliable general evidence is scarce about the depth of demand, but there is evidence emerging from local area studies (though this is patchy and certainly not consistently investigated). What is clear is that where there is little gap between market and social rents there will be less scope for the mid-market to flourish. However, in some markets where housing costs are relatively affordable, for example, in Glasgow, recent evidence suggests that, potentially, demand is strong for an intermediate product (Evans and Littlewood, 2012).

These schemes reflect a combination of willing partners coming together to address specific local needs through tailored solutions drawing on central and local government assistance as well as private sector wherewithal. Some of the governance difficulties that have been identified with other forms of innovation have been overcome through the use of special purpose vehicles, yet it is clear, if one looks at the NHT model, that setting these up can have high transactions costs and take time. Converting these models involving deferred land costs, partnership and sometimes loan guarantees from smaller to higher volume projects will heavily depend on the suitability of local markets and of willing partners. Evaluations of their cost, effectiveness, value for money and contestability have still to take place, but it would appear that the proliferation of these types of schemes suggest that they have considerable scope for wider use.

Developing bond finance for affordable housing

The tightening up of bank finance terms and conditions has led social providers to seek other avenues and in particular the capital markets and bond finance, which in turn have grown appreciably (Williams *et al.*, 2011). Fixed interest debt matches well (in the terms usually defined by credit rating agencies with good quality providers who can offer essentially index-linked rents with the added comfort of Housing Benefit. This means of raising finance has been used extensively, and increasingly, by the UK housing association sector from the early 1990s, and its use has been sensitive to market conditions (Heywood, 2010). Market conditions now strongly favour bond finance and may even make redundant the widespread approach of raising long-term finance with bank debt (NHF, 2012). The main routes that non-profit providers have used to access bond finance are:

- an issue targeted at the institutions secured on otherwise unencumbered housing stock owned by the issuing association. There have also been unsecured placements and smaller private placements;
- a syndicated bond aggregating up the financial needs of several smaller associations through, for instance, the Housing Finance Corporation or one of the new 'aggregators' such as Carduus in Scotland;
- retail bonds, which can be unsecured but sold direct to individuals as well as institutions (that is, the former may see these as relatively low risk investments to augment personal pensions and/or convert them into ISA savings vehicles – discussed further in the Select Committee (HCCLG, 2012) report and evidence). Organisations like Places for People have displayed much enthusiasm for innovation in the bond market, for example, an unsecured debt swap arrangement for £76 million over 30 years with a Japanese investor (Williams *et al*., 2011, p. 6).

More recently (6 September 2012), and as part of an infrastructure and building package aimed at macroeconomic growth stimulus, the UK government has offered the potential for state-backed guarantees for English housing association development worth £10 billion. This one-off initiative, as part of a set of wider infrastructure guarantees, will require primary legislation early in the new Parliamentary session. The guarantees are envisaged to lower the cost of debt for housing associations, but at the time of writing there is little exact detail. It may signal further moves towards the more widespread use of guarantees and away from capital subsidy. It is understood that the government will seek to encourage participation by smaller associations through aggregator bonds issued by THFC (see below). Immediate reaction has been largely positive, though one funder quoted in *Inside Housing* (7 September 2012) said that they may not participate as the guarantee could lower the price of bonds towards riskless gilts and they would be better investing in gilts directly. Such guarantees might be more useful to for-profit or commercial providers rather than large RSLs already able to secure very competitive deals in the bond market.

The proposal is part of a package, which, among other things, will suspend Section 106 affordable housing obligations for up to 75,000 private housing units' worth of development – if private developers can demonstrate that the obligations make schemes unviable. There will be a compensating addition to the capital programme for housing association development, though again the detail remains fuzzy. It also raises questions about access to land for housing associations that can be part of the £10 billion programme identified above, let alone the compensation scheme.

Bond finance clearly works for non-profit housing providers; since the beginning of 2012 more than £1billion of funding has been raised and there appears to be considerable appetite from the city (though as indicated above, there is a limited supply of purchasers). The main bond issues in recent months have supported the largest housing associations and, in particular, have helped them fund new development associated with the affordable rent programme. This reduces borrowing capacity for those operating in this part of the market. Clarke (2011) also argues that bonds are relatively inflexible, most obviously because they do not have scope for refinancing (early termination for conventional bonds can be costly – Williams *et al*., 2011, p. 5). The transactions costs, in time and money, are also high. There is also the requirement for a strong credit rating. Even if all of these hurdles are overcome, market conditions will dictate whether it is really worthwhile at a given point in time.

It remains the case that smaller social providers seeking funds from the capital markets will need to utilise aggregator or syndicated loan models. THFC is a longstanding not-for-profit organisation with a strong credit rating that acts as the principal in the bond market on-lending to the individual housing association members of the specific aggregator fund. More recently, THFC has also been able to assist associations in partnership with European funding through the European Investment Bank. There are now several aggregator funds available, reflecting the state of the market and the gap in funding facing smaller housing associations wishing to develop (see box). While these models are quite attractive in the abstract and have a long standing track record, they are syndicates and only as strong as the credit worthiness of their weakest member.

Carduus: aggregator bond funding for affordable housing

Carduus is a new Scottish start-up aggregator bond issuer aiming to provide, via five bonds, up to one billion pounds of low cost bond finance for the Scottish sector (and could generate up to 10,000 affordable rent homes). They plan to have a simple bond based on UK government bonds structures with a duration of 30 years and the terms largely shaped by their credit rating. The initial proposal envisages each association taking up between 3 and 11 per cent of the total bond, with 100 per cent financing (that is, zero grant from the government) and requires a simplified project procurement through design and build, with land owned or under option and planning permission granted. Rents will be set at intermediate or mid-market levels. Rents are expected to rise at a minimum of 3 per cent per annum. The properties have their principal repaid in full at the end of the 30 years but the association would have full title from the outset. Of course, these calculations can be improved by scale economies, lower than average land or build costs or indeed through grant or state-backed guarantee.

Locally-led innovation

Most of the focus, understandably, concerns finding ways to deliver volume or scale in the difficult present climate. This should not restrict the scope to do worthwhile innovation on a smaller scale, however, particularly when it can unlock bigger projects and make sustainable differences to affordability for specialist housing, in smaller settlements and rural contexts. There are a cluster of more local or bottom-up models that could play a wider role, even if they do not necessarily produce high volumes of affordable supply – they could unlock sites and enable wider development. Moreover, the local perspective puts local government at the centre of the policy and nests it into local housing strategies and needs and demand assessments. Critical to the current environment is that schemes should offer good value for money to the public purse. The examples we have in mind in this context are illustrated (not exhaustively) below:

- revolving funds to support land purchase and support development finance, which may include repayable loans that are also recycled for further use, stretching the use of public funds. These funds have the potential to cost-effectively remove the major market failure associated with raising development finance and unlocking land for development.

Good examples of this thinking working in practice include initiatives by both Scottish and English housing ministries, but probably most strongly through the Highland Alliance Land Fund (CIH, 2009);

- community land trusts, which retain capital growth in the trust but keep the consumption share of housing affordable either for purchasers or tenants. These restrictive covenants in the land title are local-led innovative uses of existing arrangements and reduce housing costs for households – but they still need to be developed, albeit with a slightly lower cost – particularly where the land has been originally passed on to the trust at a discounted rate from, for example, the local public sector;
- co-operative and mutual models (including for home ownership). Within the Scottish innovation fund (see above) one model was funded at £20,000 per unit to allow a mutual home ownership society to develop rural housing on a shared ownership basis – moderate income borrowers pay back a loan from the mutual society and develop an equity stake (Field *et al*., 2012). When they move, their equity share is calculated on a similar basis to the community land trust model;
- more creative local authority activities including supporting lending by housing associations (Scotland), providing mortgage guarantees, as well as supporting self-build through more supportive planning regimes, etc. East Lothian council formed a partnership with the local housing association where it effectively on-lent to the association using its own new borrowing, in order to allow social housing to be developed by the association but closely aligned to local strategic needs (CIH, 2009).

This is a cluster of policies that need to be on the shelf to be potentially usable and such experimentation should be enabled and supported.

Affordable home ownership

Shared equity for new build has become an established product, as familiar to housing associations as it is increasingly to moderate-income would-be purchasers. In that context, and subject to overcoming mortgage deposit requirements and subsidy limits, one may ask whether it is necessary to offer a proliferation of different policy means to access new supply home ownership. It is interesting to note that the successful Northern Ireland housing co-ownership model of shared ownership has worked so well because it was the only model available, and it became established and well understood as the means of entry through shared ownership into low cost home ownership in the province. The Scottish government has recently signalled its willingness to reintroduce shared ownership models having only just recently abandoned them in favour of shared equity. More generally, the complexity of different schemes and the sense that they do not often offer a lower cost than pro rata full ownership has restricted niche demand for shared ownership products (CIH in the Select Committee report (HCCLG, 2012)). While new build shared equity has a subsidy grant element, this is recyclable on resale (and maintains its real value). However, apart from its contribution to mixed tenure sustainability, it is less obvious what the incentive for social landlords is to embrace this type of model.

Perhaps the most significant development in recent years has been the moves towards providing state or private-backed mortgage guarantees to help first time buyers access higher loan to value ratios and enter home ownership. In Scotland, a partnership of home builders and lenders have launched a scheme to support first time buyer new build by diverting a proportion of sale revenue into a guarantee fund. In England, as part of the new housing strategy, the Council of Mortgage Lenders and the House Builders Federation launched the NewBuy Guarantee Scheme. With the latter, purchasers can borrow up to 95 per cent of value on a new build property because of an indemnity fund which is funded by house builders depositing 3.5 per cent of sales revenue into the scheme, plus a guarantee that will help lenders recover any losses on the mortgage. The September 2012 announcement of a construction and planning system stimulus to housing supply (see, Housing Stimulus Package 6/9/2012, House of Commons Library, 2012) included further funds to support first time buyers' access to higher loan to value loans (not limited to new supply).

Providing evidence to the Select Committee (HCCLG, 2012, p. 58), Peter Williams cautioned that this type of scheme threatened to crowd out other mortgage lending in the limited current market environment. Moreover, as the Select Committee report stresses, because of the typical new build price premium, there may well be increased risk of new purchasers falling into negative equity in a housing market that, outside of London, remains vulnerable to price falls. The Select Committee also noted that it was difficult for smaller scale developers to become involved in these sorts of scheme. It is worth nothing that traditional mortgage indemnity guarantees provided typical cover for the losses made above 85 per cent of the secured loan value. There seems to be a case, therefore, to promote the case for a more conservative but sustainable trade-off between the first time buyer loan to value ceiling, the size of typical deposits required and a deeper indemnity guarantee, for example, 10 per cent rather than 5 per cent of the loan value.

Conclusions

We have emphasised three elements in the UK context (social REITs, partnership models and bond finance), as well as identifying a cluster of other possible innovations that either do not have the scale or, in the case of the mortgage indemnities, face challenges or wider costs. We do not repeat the key points made above; instead, we now move on to a final concluding synthesis of the material examined in the previous three chapters.

7 SYNTHESIS AND CONCLUSIONS

Securing access to affordable housing has always been an objective of housing policy. For many decades the focus of housing policy in the UK has been on securing housing for the poorest and most vulnerable households. The high levels of income inequality and poverty in the UK meant that both deep supply-side subsidies and Housing Benefit were employed, bringing with them concerns about the creation of poverty neighborhoods.

The reason why policy could focus on low income groups was that owner-occupation was accessible to a wide section of the community. This was boosted by RTB and facilitated by the ready availability of mortgage finance. However, even before the credit crunch and GFC, more and more people were priced out of home-ownership, and ownership levels in England have been declining markedly among young and now middle-aged groups (Stephens, 2011b).

These problems have been overlaid by the problem of persistent price volatility in the housing market, causing much social and economic damage. These issues were addressed by the JRF Housing Market Taskforce (Stephens, 2011b), which spelled out the need to secure marked improvements in the level of new supply, along with a series of other measures to stabilise the housing market within the context of a balanced tenure choice.

It is in this context that this report has addressed the question of housing supply. There remains a growing need for more traditional social rented housing, which is the only means of securing secure and affordable housing for those households who cannot safely obtain home-ownership (Stephens, 2011b). There is a strong economic, as well as social case, for arguing that the government should be prepared to increase borrowing to finance a social housing programme. The UK government can borrow very cheaply and such a programme would aid economic recovery, while supporting construction.

It is also clear that the increases in general supply needed to make housing affordable once again to the majority of households is not going to be obtained in the near future. The focus of this report was primarily on examining programmes in other countries where traditions of providing relatively shallow subsidies to boost housing supply are more strongly entrenched than in the UK.

The programmes examined were drawn from a variety of countries representing a range of social and economic as well as housing, systems. In considering the suitability of individual programmes for transfer to the UK, we took into account the wider context. For this reason, no scheme could be adopted without adaptation to a UK context. There is no 'silver bullet', but there are ideas that could usefully be adapted and adopted.

Key evidence review messages

- There needs to be recognition that the growth in more intermediate or affordable models will encourage the shift away from new provision for deeper subsidy social housing, which will have profound consequences for those on low incomes.
- The broader structure and policy framework that constitutes the national housing system, including welfare benefits, is a critical frame within which approaches to finance innovation takes place and policy transfer is contemplated.
- Many potential approaches exist (or can be readily conceived) but they all have strengths and weaknesses when set against reasonable key tests, such as scalability, value for money, time to market and effective targeting.
- There needs to be clear overarching policy vision, not just about individual policies, but the overall mix of policies and their system-level coherence, including how they are delivered and by whom.
- The understandable effort to develop a larger private sector contribution has knock-on effects elsewhere in the system such as challenging not-for-profit governance ramifications.

While we think that all of the policies examined (Chapters 4–6) have merit and are ideas at least worth further debate in a UK context, we would stress the potential of a sub-set:

- the Spanish VPO developer/occupier system of new supply subsidy. It is flexible (though not completely transparent) but has suffered in the recent downturn. The scheme is, however, readily transferable (it would not require new institutional infrastructure) and could support stimulus activity;
- the Irish private renting discounted rent long lease model that also serves to address work incentives and augment affordable supply by binding the private rented sector into long leases and sub-market rents;
- the Australian NRAS tax credit application of the US low-income housing tax credit model. The combination of competition between providers, opportunities to blend subsidy and the beneficial place making aspects of the policy are all attractive innovations in a UK context;
- the Danish housing association national surplus fund, which although based on principles of solidarity that may seem alien in a UK context, allows surplus funds to be used creatively, though one needs to recognise that government may simply offset the fund with lower subsidy. However,

more fundamentally, this may be a more acceptable way voluntarily to unlock housing association long-term reserves;

- loan guarantees backed by the central or local state but more on the lines of the Scottish National Housing Trust rather than as a way of generally lowering the cost of bonds (as it appears the new English £10 billion fund will do) and developing a Dutch-style guarantee and governance model;
- first time buyer policies that assist with the deposit problem – either via the Canadian silent mortgage or through adjustment to the FirstBuy or NewBuy models such that the indemnity for the latter operates at a higher deposit percentage than the 5 per cent currently in practice.

Emerging themes

In the course of the work, a number of broader themes also emerged. First, there is evidently an appetite for **state-backed guarantees** but, as suggested above, there should be a note of caution.

Second, **competition** or **contestability** between (for-profit and non-profit) providers is important. This can encourage efficiency and experimentation through competition. Resources for affordable housing are scarce and if these models encourage their conservation and competition for demand, then this is a positive development.

Third, many countries indicated that **subsidy can be distributed from the centre** (for example, national tax authorities or federal programmes) to lower tiers of government where there is freedom at the more local level to augment subsidy (for example, with land) for locally-tailored affordable housing solutions. In our devolved nation state such arrangements are also possible, particularly if we were to move to the use of tax credits at the UK level, possibly augmented with devolved government subsidy.

Fourth, a case that can be made for **flexible, blended use of subsidy** – again, in the interests of experimentation and tailored solutions. An emerging 'localism' and devolution in housing policies, and not just in the UK, means that innovation in housing policy is increasingly 'bottom-up' and that national or federal policy responses are increasingly framed around relatively simple supports that can be locally blended and augmented to serve different purposes.

However, the need for value for money requires that tests have to be in place to ensure that subsidy is not over-provided on individual units or poorly targeted. We do not think it is beyond the wit of regulators to operate oversight of subsidy systems that could address this point, either through tests by relevant agencies checking for value for money and efficiency or through bidding mechanisms, such as auctions and challenge funds.

Fifth, we have seen in different European systems (including the ones with more generous social security systems) that social housing can benefit financially (and in terms of its governance) from a more **solidarity-based** or **collaborative** set of structures. While this may not be culturally translatable, it may be feasible on a smaller more local or specialist scale.

Sixth, there is increased interest in **management income streams** associated with the REITS, sale and leaseback vehicles and the tax credit models discussed earlier. Additional revenue is of course increasingly important to social providers, but there are risks: investment partners may seek alternative managers – that is, it is not a guaranteed source of income (nor, arguably, should it be).

Seventh, in contrast to complex schemes such as the LIHTC, we have also seen the value of **simple schemes** that are readily communicated to users and where the effects are simple to follow and unintended consequences less likely. The Canadian silent mortgage and policies such as revolving funds are straightforward and appear less prone to unintended consequences.

Eighth, the intended shift upmarket has meant relatively **shallow subsidy per unit** (particularly where the offer is time-limited: deeper subsidy is still required for affordable housing in perpetuity). With overall programmes of pre-2010 size this can mean a stretching of that resource – but of course the reality is that programmes have been massively scaled back.

Ninth, the key complementary measure alongside shallower subsidy is to '**sweat' the existing assets** of providers. Indeed, one can reasonably interpret the AHP as just that, capturing the rise in balance sheets and financial capacity associated with assets owned by housing associations increased in value through the property boom.

Finally, the scope for innovation is intimately related to the **regulatory stance** – not just in terms of social housing's governance and regulation but in particular, the interface between non-profit housing and the private financial sector and its regulation. Also relevant in this context are the public accounting rules that determine the envelope of what is possible when subsidy or public loans or indeed guarantees are involved.

The need for a wider long-term housing policy framework

The focus has been on making a difference in the current environment. We also think that policies need to be considered in the longer term wherein a wider set of policies seek to minimise fundamental problems and market failures. This might then allow a better prioritisation of resources towards those most in need.

What would such a framework look like? Lawson *et al.* (2010) argued, first, for principles that embrace a public vision and objectives of affordable housing. In other words, a broad stakeholder consensus is required and not just one governed by the needs of private finance (though that should not be overlooked or fatally compromised). A second useful element is that they call for efficient organisation of the sector in terms of regulation and governance, subsidy design, cross-subsidy and in encouraging competition by providers. Third, they propose that low-income rental subsidies from government rather than individual provider rental policy should determine affordability outcomes for lower income households. They also suggest that national priorities should find local delivery form in practice.

We would add three further dimensions:

- Affordable housing policy should be located in a wider vision of place and the boundaries between the market and the state based on long-term policies to address market failure and combatting housing or place-based poverty.
- National policies must be based on locally derived consistent estimates of need and market outcomes, in order to provide the most effective investment case for scarce housing resources. This evidence base is an essential public good to improve the efficient use of resources for affordable supply.
- We also propose developing rule consistency in housing policy. In macroeconomics policy makers are encouraged to establish a set of rules to help meet macro objectives such as in relation to public borrowing or monetary expansion. Critically, any future policy innovations must be consistent with those rules. The idea would be that once the vision for

affordable housing is agreed and its operational version articulated – new policies would need to pass an impact assessment that judged them to be sufficiently consistent with that set of objectives. This may seem obvious but recent experience suggests otherwise.

The substance of housing policy in the long run should address principal market failures. We concur with the Joseph Rowntree Foundation housing market taskforce that market volatility should be minimised. That requires looking again at housing taxation and the safety net for vulnerable home-owners. It also would mean thinking constructively about the wider market role of the private rented sector. We agree also with Kate Barker and others (Stephens, 2011b) that the long-term supply elasticity of housing has to be raised systematically and that will involve changes to land planning (see the companion international evidence review on land by CCHPR for the Joseph Rowntree Foundation).

Third, the immediate key market failure in the mortgage market has to be addressed. The likelihood, however, is that the fundamentals constraining banks are so large compared to likely intervention, that significant improvements to mortgage lending will take several years. Unfortunately, constrained mortgage markets will be with us for as long as greatly reduced public funding. Finally, and despite the welfare benefit reforms underway, we should not lose sight of the need to reappraise the proper role and structure of a housing allowance in the long term.

Earlier, the radical packages of IPPR and Policy Exchange were presented as 'all or nothing' proposals. We think the focus on correcting market failures and reforming in areas of taxation, benefits and housing supply are pretty radical themselves, but they do not per se require dramatic changes to non-market housing. We caution against major overhaul of a sector characterised by long-term contracts and commitments to its tenants.

Conclusions

Without step-change, the affordable rent sector not social rent is from where new supply will predominantly come. This is likely to segment non-market housing into a new and growing affordable sector targeted at moderate-income in-work households, one in competition with the private rented sector. Alongside it will be a weakly growing or static social sector housing stock, one priced out of new subsidised development, increasingly housing the lowest income households and facing a growing queue of unmet need. It is not clear how the growth of the former will filter down into more opportunities for the latter. This is the biggest single challenge facing affordable housing policy on the current trajectory.

Governments across the UK in this scenario are faced with difficult choices. One choice would be to follow Scotland's direction and publically target a proportion of its programme (2/3) as social rent as opposed to affordable. This commitment may turn out to be unsustainable but they do have a (presently) unique ability to draw more on (comparatively cheaper) council house building if required. Council housing finance reform in England is hugely important but as elsewhere it is the rules governing financial capacity and the imposition of caps on borrowing that constrain what is possible. The alternative is to accept that new social housing will not expand and meeting need will inevitably require a greater input from the private rented sector, while higher rents in the affordable sector risk greater work disincentives and higher Exchequer benefit costs.

The evidence review focused on a small number of key criteria, chief among them are scale, speed of implementation and value for money. Large-scale programmes associated with new models take time as the affordable rent programme indicates and the evolution of the NHT in Scotland demonstrate. However, there are many smaller-scale innovations that are able to make a positive contribution and their lack of scale should not be a deterrent to their continued effective contribution in rural markets, land markets, development finance, etc. Equally, the creative use of syndicated or aggregating bonds could in the current market environment offer scale to many smaller special providers unable otherwise to access finance, but which are perfectly robust financially.

The financial crisis and its ramifications have initiated a fundamental reassessment of how non-market housing will be provided and who will likely receive it and how much that will cost. This will in turn put conventional social housing under increased pressure of housing need. Against this background we have explored policies that can add to social and primarily affordable supply but conclude that volume innovation takes time and does not come for free. However, there are many genuinely positive contributions that we can draw from, including in different parts of the UK. It is essential that we do so.

NOTES

1 Present in the half-day discussion: Kenneth Gibb, Duncan Maclennan, Mark Stephens, Tony O'Sullivan (Newhaven Research), Derek Ballantyne) Housing Services Corporation, Toronto), Per Ahren (Norwegian State Housing Bank), Michael Lennon (Housing Choices Australia), Bob Millar (New City Vision), Brigitta Gomez-Neilson (Danish Institute of Governmental Research), Alberdi Baralides (Eurocatalyst, Spain).

2 We reviewed both the French and Austrian policies in our European assessment for this project but decided not to develop them as proposals since they did not meet our criteria.

3 Based on Bank of England spot rate exchange rate, 17 January 2013, at 1.5165 Australian dollars to the pound sterling.

4 The minimum and maximum income limits for different household types is currently: one adult 42,718–53,398; two adults 59,057–73,822; three adults 75,396–94,245; four adults 91,735–114,669; sole parent with one child 59,099–73,874; sole parent with two children 73,267–91,584; sole parent with three children 87,435–109,294; couple with one child 73,225–91,532; couple with two children 87,393–109,242; couple with three children 101,561–126,952.

5 Based on Bank of England spot rate exchange rate, 17 January 2013, at 1.5736 Canadian dollars to the pound sterling.

6 Desai *et al.* 2011 provide a more detailed, nuanced description of how the system operates. 'The LIHTC program allocates two types of housing credits, depending on how a project is financed. The first type of credit ("9 per cent credit") is allocated to new construction projects that receive no other federal subsidies, with credits apportioned to states based on their population. Initial allocations for the program were $1.25 per capita, increased to $1.50 in 2002, $1.75 in 2003, and indexed for inflation thereafter. If a project is financed with private-activity tax exempt bonds, it is eligible for the second type of credit ("4 per cent credit"). Unlike the 9 per cent credit, the 4 per cent credits are capped indirectly through state private activity bond caps, rather than per capita. Each dollar of allocated credit entitles the investor to a dollar tax credit each year for ten years.' (p. 2).

7 This section is based on a pro-forma completed by Baralides Alberdi.

8 This section is based on a pro-forma completed by Brigitta Gomez-Neilson.

9 This section is based on a pro-forma completed by Michelle Norris.

10 This section is based on a pro-forma completed by Marja Elsinga and Kees Dol.

11 Exchange rate at 18 January 2013 (European Central Bank) – 0.8372. This exchange rate is used throughout the report.

12 Vestia is a Rotterdam-based housing association with a stock of 89,000 properties, which was threatened with bankruptcy after an ill-judged interest rate swap left it short of €2.1 billion. The situation did not arise from the financial crisis, but from an internal error of judgement that may have been caused by deficiencies in its internal governance. It was therefore primarily a question of treasury management, and may have fallen outside the Housing Act. To prevent Vestia from entering bankruptcy proceedings, WSW provided a liquidity facility of ca. €1.5 billion. CFV has committed another €700 million in support over ten years, which will require other associations to increase their contributions to the fund. Vestia will meet its obligations through a mixture of rent increases and sale of assets. Ultimately some €2 billion of investment capacity will have been lost to the sector, but on the other hand solidarity appears to have worked to prevent the loss of triple A ratings for the sector.

13 This section is based on a pro-forma completed by Stefan Kofner.

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