

**G15 RESPONSE TO HCA CONSULTATION PAPER:  
SOCIAL HOUSING ASSISTANCE PRINCIPLES OF RECOVERY**

**1. Background and Introduction**

1.1 G15 is a group of London housing associations and comprises:

|                        |                            |
|------------------------|----------------------------|
| A2 Dominion Group      | Metropolitan Housing Trust |
| Affinity Sutton        | Notting Hill Housing       |
| Amicus Horizon Group   | Network Housing Group      |
| Catalyst Housing Group | Peabody                    |
| Circle Anglia          | Southern Housing Group     |
| East Thames Group      | The Hyde Group             |
| Family Mosaic          | The L&Q Group              |
| Genesis Group          |                            |

1.2 G15 makes a significant contribution to London life. Collectively, G15 associations house around one in ten Londoners and manage around 410,000 homes. We build approximately 10,000 new homes every year. We invest over £25m annually in economic and community development to create thriving, sustainable neighbourhoods across the capital – in areas such as employment, skills, education, health and well-being, volunteering, financial inclusion, family intervention, welfare benefits support, supporting older and vulnerable people and engaging younger people.

1.3 This document provides a response from G15 to the HCA's Consultation paper on Social Housing Assistance - Principles of recovery.

1.4 G.15 is committed to finding new ways of providing housing in London in the context of severe pressures on public resources. Individually and collectively, we are working on ideas to develop and complement new products and enhance our efficiency. We are keen to generate funds for investment in our existing homes, provide new ones and deliver better services. We want to work with the HCA on other ideas. This paper focuses specifically on the consultation document produced by the HCA. Our overall concern is that grant to equity would reduce our capacity, as explained in the paper.

**2 Executive Summary**

2.1 G15 believes the proposals included in the consultation paper will potentially increase grant requirements, reduce affordability and impact on the overall financial health of HAs.

2.2 Because HAs are regulated organisations and do not distribute profits either during initial development or long term ownership, their assets are fully recycled for future use. A strong HA sector has been very beneficial in delivering government policy cost effectively over many years.

2.3 We support the proposal not to change the current recycling arrangements on social rented homes and that these should remain as now for housing associations.

2.4 The proposals are likely to increase grant requirements for both LCHO and social rent because RCGF repayment obligations are taken into account in calculating initial grant bids, reducing the amount initially bid for. As a result

increases in future repayments into RCGF run the risk of directly increasing the initial grant requirements across both LCHO and social rent in mixed tenure schemes.

- 2.5 RCGF also plays an important role in helping HAs to manage the risk of development. Having direct access to RCGF allows opportunity sites to be secured early. Adding risk and reducing future income can be expected to directly reduce development programmes at a time when all resources will be needed to maintain activity. Reductions in future resources will also impact on lenders assessments of the overall financial viability of HAs, potentially restricting lending or increasing rates. Any shortfalls in future income would need to be met by either securing additional debt or scaling back growth, both of which result in reduced capacity.
- 2.6 LCHO affordability is likely to suffer because reductions in assumed future receipts will impact on HAs' ability to assist those on modest incomes into LCHO.
- 2.7 This response proposes that any surplus or loss on first tranche sale is retained by the RSL, with no investment repaid or recycled at first tranche and that investment recovery is limited to the value uplift of future staircasing receipts. A simple and easy to understand approach would be necessary to ensure a uniform treatment is adopted across the sector
- 2.8 G15 support retaining the current 3 year limit for recycling.
- 2.9 A number of examples are attached which illustrate the impact of various assumptions on grant and show the proposals could:-
  - Generate a requirement for more grant when first tranche sales are completed.
  - Generate a higher grant requirement if values decrease on staircasing.
  - Reduce project viability leading to a requirement for additional grant on social rented homes.

### **3. Implications for Recovery of Equity Investment**

- 3.1 G15 supports maintaining the distinction between the HA sector and other providers in recovering capital grants. HAs are regulated organisations. They do not distribute profits either during initial development or long term ownership.
- 3.2 Unlike other registered providers the whole of their resources are therefore concentrated on providing, managing, improving and supporting affordable housing.

### **4. Homes for Social Rental**

- 4.1 We support the proposal not to change the current recycling arrangements on social rented homes and that these will remain as now for housing associations.

### **5. Homes for Intermediate Rent and Low Cost Home Ownership**

- 5.1 HAs use grant to help make shared ownership more affordable to the priority groups targeted by government who will most benefit from assistance to access the property market.
- 5.2 In order to model financial viability in a competitive grant market HAs generally take a view about long term prospects for the timing, percentage and value of future staircasing. This future staircasing income is factored into 30 year viability models and helps reduce the grant bid for. Current RCGF repayment obligations are taken into account in this calculation. In effect the initial grant bid is discounted to take account estimated future returns.
- 5.3 However the majority of grant funded schemes incorporate other tenures and in particular social rent. Because of the higher levels of grant required for social rent HAs look for ways to meet grant efficiency targets by merging their LCHO and Social Rent feasibilities before bidding on mixed tenure schemes to give a blended grant.
- 5.4 Applying assumed LCHO future staircasing income in this way helps reduce the grant bid for on social rent units, not just LCHO, which is generally lower than it would have been on a standalone rented scheme.
- 5.5 As a result increases in future repayments into RCGF run the risk of directly increasing the initial grant requirement on both LCHO and social rent.

## **6. Other Implications**

- 6.1 Because HAs don't distribute profits all resources available to the organisations are used to further their primary objectives, largely in accordance with regulatory requirements. Reductions in these resources will have a number of direct and indirect affects in addition to the impact on grant mentioned above.
- 6.2 Reductions in future resources will impact on lenders assessments of the overall financial viability of HAs, potentially restricting lending or increasing rates.
- 6.3 Added risk and reduced future income will have a negative effect on development activity and can be expected to directly reduce development programmes.
- 6.4 Finance returned to the HCA is likely to be netted off against future funding allocations, reducing the overall resources available to support affordable housing provision in the future.
- 6.5 LCHO affordability is likely to suffer. This is a key factor within HAs feasibility assessments. Assumptions about long term staircasing receipts help make it viable for initial sale tranches to be reduced, therefore helping to make SO more affordable to first time buyers, particularly in London and the Southeast. Recycling larger proportions of future income will reduce receipts and increase initial purchase tranches, requiring buyers to have higher salaries to access LCHO.
- 6.6 RSLs have funded Decent Homes programmes from normal operating resources, unlike local authorities who have access to central government grants. HAs have been able to achieve this while developing new homes in

part due to staircasing surpluses over and above that required for RCGF recycling. Reductions in this resource may mean slower progress in meeting Decent Homes (and future stock enhancement) targets or more likely future regulation will require the same investment in stock, directly reducing the capacity for new development.

- 6.7 There are growing Government and regulatory expectations of HAs to extend their community development activities. These can not generally be funded directly from social rent income given the rent influencing arrangements currently in place. This is another area supported by staircasing surpluses which is likely to suffer as a result of any increase in the amounts paid into RCGF.
- 6.8 Current restrictions on mortgage funding and the limited number of affordable mortgages suitable for first time buyers is already impacting on shared ownership sales and therefore the risk and cost of developing. HCA assistance with conversion to intermediate rent has been very helpful in reducing the impact of this but a recent report from CML (“the outlook for mortgage funding markets in the UK in 2010-2015”) raises further doubts about future mortgage availability over the next few years and this is likely to have the greatest impact on low cost home ownership purchasers. Reductions in assumed future receipts will further impact on HAs’ ability to assist those on modest incomes into LCHO.

## 7. Key Questions and Next Steps

G15’s responses to the consultation papers key questions, informed by the background above, are set out below:

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

#### Answer:

For many of the reasons set out above G15 believes that retaining option 1 is the most appropriate solution. RCGF is recycled in any event (or returned to the HCA). Its can only be used for qualifying purposes and its use is subject to HCA approval.

RCGF plays an important role in helping HAs to manage the risk of development. Having direct access to RCGF allows opportunity sites to be secured early without prior allocation of SHG, to assist in meeting viability problems and is regularly used by the HCA as a helpful top-up to assist in approving projects.

All these activities align with HCA objectives. Removing this flexibility will impact on supply and the risk appetite of developing HAs.

If option 1 is not selected G15 would favour option 2 over option 3.

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

#### Answer:

Yes. If there is to be a different regime we agree it should only apply to LCHO.

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

Answer:

The first impact would be on project feasibilities, which assume staircasing receipts in future years and factor these assumptions into scheme viability assessments. This enables grant to be reduced at bid stage. If no account were taken of future staircasing, initial grant requirements would be significantly higher. Importantly these grant reductions are not confined to LCHO but are generally extended across all tenures in mixed tenure projects. In particular this is responding to the drive to minimise grant on social rent homes. The effect of linking RCGF to uplifts in value & requiring its recycling or return would be to directly increase grant rates on new LCHO and social rent projects.

The second impact is on the affordability of LCHO to priority purchasers. This is a key factor within HAs' feasibility assessments. Assumptions about long term staircasing receipts make it viable for initial sale tranches to be reduced, therefore helping to make SO more affordable to the first time buyers prioritised by Government. Recycling larger proportions of future income will reduce receipts and harm affordability by requiring purchasers to have higher salaries to access LCHO.

The third key impact is the wider effect on RSL business plans. Under both options 2 and 3, associations' future accounting surpluses would reduce; a reduction in surplus would result in a weakening of interest cover and gearing covenants and directly impact on future capacity to develop new social homes. Option 3 would further weaken capacity, due to the negative impact it would have on an association's cashflow. The resulting shortfall in cash would need to be met by either securing additional debt or scaling back growth, both of which result in reducing capacity.

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

Answer:

Decent homes programmes (and the stock improvement standards that will succeed decent homes) are key government objectives.

Unlike local authorities, HAs have generally been able to invest in meeting decent homes standards without government assistance. A significant contribution to the resources required to achieve that while continuing new development has come from retention of staircasing receipts. If receipts were reduced in future (due to increased RCGF liabilities) it is likely HAs would need additional financial support from the Government to meet decent homes and other stock improvement standards if the development programme was to be maximised.

The requirement to meet decent homes standards on older affordable housing is a distinction between HAs and other registered providers who are not regulated and do not have such obligations. In our view it is reasonable to have different requirements for regulated not for profit HAs as distinct from other providers.

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

Answer:

Linking investment assistance recovery to value at the point assistance is awarded and then at the point of first tranche, would provide a disincentive, when values rise, to spend more on providing added benefits to residents to help create more sustainable communities. HAs would be encouraged to maintain profit margins on first tranches, so that surpluses exist to meet the requirement to distribute value uplifts. This would be at the expense of ensuring quality and sustainable homes are developed, therefore contributing to lower revenue costs in the future.

In order to align funding objectives and accounting treatment with investment recovery, it is recommended that investment assistance is only used to fund the unsold equity of the property. The first tranche sale is sold at market value, whereas the unsold equity has a subsidised rent applied, therefore the investment assistance should apply to the unsold equity only.

It is recommended that any surplus or loss on first tranche sale is retained by the RSL, with no investment repaid or recycled at first tranche.

It is recommended that investment recovery is limited to the value uplift of future staircasing receipts, as shown in the worked example below.

|  |                            |
|--|----------------------------|
| Property Value at First Tranche  | £200k                      |
| First Tranche %  | 25%                        |
| First Tranche Value  | £50k                       |
| Unsold Equity Value  | £150k                      |
| HCA investment in Unsold Equity  | £45k                       |
| Investment as a proportion of value of unsold equity (Investment Rate) | $45/150 = 30\%$            |
| Property Value at Second Tranche                                       | £220k                      |
| Second Tranche %   | 25%                        |
| Second Tranche Value   | £55k                       |
| HCA investment recovered   | $30\% \times 55k = £16.5k$ |

This approach would result in RSLs continuing to take measured construction, sales and long term management, maintenance and treasury risk with the HCA only sharing the risk of long term capital appreciation of unsold equity in LCHO properties. Linking investment recovery to anything other than uplift in value of staircasing receipts, would require examining revenue losses, and would be a significant administrative burden.

A simple and easy to understand approach will ensure a uniform treatment is adopted across the sector. It will also prevent varied interpretations by associations and their auditors on the treatment of recovery, which has existed in the past.

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

Answer:

Individuals decision to enter the housing market is dependant on market conditions and personal circumstances. The underlying investment structure would not impact on the customer's decision unless it impacted on price or availability. The price will be dictated by market conditions however option 2 and 3 would impact on the level of supply and therefore availability.

The G15 supports flexibility of tenure and encourages intermediate renters entering into responsible home ownership. This creates sustainable communities and can contribute to surplus generation to meet future social housing objectives of new supply or investing in existing social homes. Both option 1 and 2 would reduce surpluses from this type of activity, impacting on capacity to develop. Rent to purchase models would need to charge higher rents to remain viable, which would result in reduced affordability to customers.

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

Answer:

G15 agrees it is essential that changes (if any) apply from the agreed date of any implementation, there should be no backdating.

It needs to be absolutely clear at bid stage if higher RCGF repayments have to be factored into feasibilities. Because of this we believe there should be a 12 month lead in if there are any changes.

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

Answer:

1. It is important to note that recent upward pressure on grant rates is mainly a result of the credit crunch substantially cutting back mortgage availability and increasing borrowing costs. The resulting market value reductions have severely effected S106 cross subsidy, which until the recent past had significantly reduced scheme costs and therefore grant requirements.
2. At present HAs are required to repay RCGF if it is not used for approved purposes within 3 years. This ensures it is used (or returned) and gives the HA time to identify suitable projects. The 3 year period is helpful to allow time to build up usable amounts in the local areas where its use is designated. G15 would therefore support retaining the current 3 year limit for recycling.
3. The G15 would welcome more consideration on the impact changes would have on the accounting treatment and tax implications of HCA equity investment, the full accounting and tax implication can only be determined once a detailed proposal including its legal structure is agreed. Clarification is required on what would happen in the event of a fall in values, and how losses would be distributed. Under the current grant regime, grant is abated to protect RSLs when the market drops.
4. For RSLs who use shared ownership unsold equity as security for lending, lenders will need to be given sufficient comfort that in the event of default that their interest is protected.
5. Because the tranche and value of individual transactions, both initially and on subsequent staircasing are unpredictable, the benefit of aggregating gains and losses across schemes needs to be explored in more detail.

**8. Examples**

- 8.1 A number of examples are attached which illustrate the impact of various assumptions on grant. These use the figures in the HCAs illustrations for ease of comparability.

**Effect of Higher or Lower Equity Shares at Initial Sale – Annex 1**

This shows how a surplus or loss would be generated if the first tranche is not sold at the 40% level initially assumed. HAs make assumptions on average sales tranches across each project. As SO is generally sold at the maximum tranche affordable by the applicant, but sales may be constrained by S106 requirements, it is not possible to be precise about whether a surplus or loss will be made on aggregate first tranche sales. If losses and gains were to be shared as proposed in the consultation paper this could generate a requirement for more grant once first tranche sales were completed.

**Impact of Value Growth/Reductions on Grant Recovery – Annex 2**

This shows how decreases in value on staircasing can generate a higher grant requirement. There may not have been increases on previous staircasings to offset this.

**Impact on Rent and Shared Ownership Schemes - Annex 3**

This shows how a positive NPV generated on LCHO can be made available to support an associated scheme (most often social rented homes on the same mixed tenure site which may have a negative NPV due to competitive pressures to reduce grant).

**Project Example – Annex 4**

This shows how the result of Annex 3 could be applied to enable the overall scheme to meet satisfactory viability levels, and how recovery of additional grant as proposed in the consultation paper would reduce the NPV leading to a requirement for an equivalent amount of additional grant on the social rented homes.

## G15 – March 2010

### Annex 1

#### Effect of Higher or Lower Equity Shares at Initial Sale

|   | Initial Sale + 10% | Initial Sale + 0% | Initial Sale - 10% |
|---|--------------------|-------------------|--------------------|
| Type  | Initial Sale       | Initial Sale      | Initial Sale       |
| HCA investment in unit                                      | £ 21,107           | £ 21,107          | £ 21,107           |
| Estimated value of property at completion                   | £ 122,000          | £ 122,000         | £ 122,000          |
| Expected first tranche sale                                 | 40%                | 40%               | 40%                |
| Expected amount of unsold equity following 1st tranche sale | 60%                | 60%               | 60%                |
| Investment as a proportion of estimated unsold equity       | 28.83%             | 28.83%            | 28.83%             |
| Value of property at first tranche sale                     | £ 122,000          | £ 122,000         | £ 122,000          |
| Proportion of equity purchased                              | 50%                | 40%               | 30%                |
| Value of sale   | £ 61,000           | £ 48,800          | £ 36,600           |
| Additional equity purchased                                 | 10%                | 0%                | -10%               |
| Investment to be repaid                                     | £ 3,518            | £ -               | £ 3,518            |
| Equity uplift   | £ -                | £ -               | £ -                |
| Value of equity uplift to be recovered                      | £ -                | £ -               | £ -                |
| Total amount to be recovered to the HCA                     | £ 3,518            | £ -               | £ 3,518            |
| Amount that would be recycled under current arrangements    | £ -                | £ -               | £ -                |

## Annex 2

### Impact of Value Growth/Reductions on Grant Recovery

|   | No increase in value for 5 years | Increase in value 5% pa for 5 years | Decrease in value 2% pa for 5 years |
|---|----------------------------------|-------------------------------------|-------------------------------------|
| <i>Type</i>   | <i>Staircasing</i>               | <i>Staircasing</i>                  | <i>Staircasing</i>                  |
| <i>Change in value pa</i>                                   | 0%                               | +5%                                 | -2%                                 |
| <i>Period (years)</i>                                       | 5                                | 5                                   | 5                                   |
| HCA investment in unit                                      | £ 21,107                         | £ 21,107                            | £ 21,107                            |
| Estimated value of property at completion                   | £ 122,000                        | £ 122,000                           | £ 122,000                           |
| Expected first tranche sale                                 | 40%                              | 40%                                 | 40%                                 |
| Expected amount of unsold equity following 1st tranche sale | 60%                              | 60%                                 | 60%                                 |
| Investment as a proportion of estimated unsold equity       | 28.83%                           | 28.83%                              | 28.83%                              |

|  |           |           |           |
|--|-----------|-----------|-----------|
| <i>Value of property at first staircasing</i>            | £ 122,000 | £ 155,706 | £ 110,278 |
| Proportion of equity purchased at staircasing            | 50%       | 10%       | 10%       |
| Value of sale  | £ 61,000  | £ 15,571  | £ 11,028  |
| Additional equity purchased                              | 10%       | 10%       | 10%       |
| Investment to be repaid                                  | £ 3,518   | £ 3,518   | £ 3,518   |
| Equity uplift  | £ -       | £ 33,706  | £ 11,722  |
| Value of equity uplift to be recovered                   | £ -       | £ 972     | £ 338     |
| Total amount to be recovered to the HCA                  | £ 3,518   | £ 4,490   | £ 3,180   |
| Amount that would be recycled under current arrangements | £ 3,518   | £ 3,518   | £ 3,518   |

### Annex 3

#### Impact on Rent and Shared Ownership Schemes

|   | Initial sale        | Staircasing out after 10 years |
|---|---------------------|--------------------------------|
| <i>Type</i>   | <i>Initial sale</i> | <i>Staircasing</i>             |
| <i>Change in value pa</i>                                   | 0%                  | +5%                            |
| <i>Period (years)</i>                                       | -                   | 10                             |
| HCA investment in unit                                      | £ 21,107            | £ 21,107                       |
| Estimated value of property at completion                   | £ 122,000           | £ 122,000                      |
| Expected first tranche sale                                 | 40%                 | 40%                            |
| Expected amount of unsold equity following 1st tranche sale | 60%                 | 60%                            |
| Investment as a proportion of estimated unsold equity       | 28.83%              | 28.83%                         |

|  |           |           |
|--|-----------|-----------|
| <i>Value of property at first staircasing</i>            | £ 122,000 | £ 198,725 |
| Proportion of equity purchased at staircasing            | 40%       | 60%       |
| Value of sale  | £ 48,800  | £ 119,235 |
| Additional equity purchased                              | 0%        | 60%       |
| Investment to be repaid                                  | £ -       | £ 21,107  |
| Equity uplift  | £ -       | £ 76,725  |
| Value of equity uplift to be recovered                   | £ -       | £ 13,274  |
| Total amount to be recovered to the HCA                  | £ -       | £ 34,381  |
| Amount that would be recycled under current arrangements | £ -       | £ 21,107  |

|  |  |         |
|--|--|---------|
| NPV generated from using current arrangements  |  | £ 8,149 |
| NPV generated from using proposed arrangements |  | £ -     |
| Additional grant required under new proposals  |  | £ 8,149 |
| Assumed discount rate                          |  | 5%      |

## Annex 4

### Project Example

**Current Arrangements - rented scheme is cross-subsidised by shared ownership scheme, project breaks even overall**

| Sample Scheme     | S/O     | Rent     | Combined Scheme |
|-------------------|---------|----------|-----------------|
| Net Present Value | £ 8,149 | -£ 8,149 | £ -             |

**Proposed Arrangements - shared ownership scheme cannot subsidise rented scheme, project generates negative NPV**

| Sample Scheme     | S/O | Rent     | Combined Scheme |
|-------------------|-----|----------|-----------------|
| Net Present Value | £ - | -£ 8,149 | -£ 8,149        |

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