

REFERENCE: 026

ORGANISATION: SCOTTISH FEDERATION OF HOUSING ASSOCIATIONS

CATEGORY: INTERMEDIARY ORGANISATION



A RESPONSE FROM THE SCOTTISH FEDERATION OF HOUSING ASSOCIATIONS

“BETTER VALUE FROM HAG – CHANGES TO GRANT IN 2008/9”

MARCH 2008



Introduction

- .1. As the representative body for the principle builders of new social housing in Scotland, the Scottish Federation of Housing Associations (SFHA) welcomes the opportunity to comment upon the Scottish Government's consultation, "Better value from Housing Association Grant – changes to grant in 2008/9" published in February 2008.
- .2. Housing associations in Scotland own and manage 40% of the country's affordable social housing stock. This represents 261,477 homes across Scotland.
- .3. The housing association sector has an asset value base of £7 billion in Scotland. This is concentrated in some of the poorest communities in our country.
- .4. This response has been developed following consultation with all of our members across Scotland.

General Comment

- .1. In general the Scottish Federation of Housing Association's welcomes the government's intention to increase the supply of affordable housing in Scotland, as outlined in both "Firm Foundations" and the "Review of SPP3 – Planning for Housing".
- .2. We are also supportive of the Scottish Government's view that it is vital that publicly funded procurement must be as efficient as possible while securing maximum benefit for the communities in which the investment is being made.
- .3. The Scottish Federation of Housing Associations accepts that the Scottish Government is working within an environment where there are constraints on public spending and that this is likely to continue to be the case for the foreseeable future.
- .4. We are concerned, however, with the scale of the changes to HAG subsidy levels suggested in this consultation document, and at the likely impact on the sector. It is our view that the scale of the proposals that the Scottish Government propose would have a detrimental impact on the health and sustainability of the sector in the medium term. We would urge caution and ask that the Scottish Government works with the SFHA and housing associations to develop and build on the many strengths of the sector.
- .5. The Scottish Federation of Housing Associations believes that it is important to maintain the strengths that a diverse Housing Association sector brings to communities across Scotland. Any change in the allocation of HAG and procurement of affordable housing should build on examples of best practice and the strengths of the sector. We are concerned that the significant increase in level of private finance proposed will limit the number of associations who both develop and



manage new build stock. This could lead to a lack of diversity and could also limit competition and innovation in the future.

- .6. The Scottish Federation of Housing Associations wishes to register concern that when the document came out for consultation, a key assumption (the private finance factor) was not included. The SFHA commissioned an independent consultant to carry out some commentary and modelling on the impact of the proposed new assumptions. We feel strongly, however, that the document should not have come out for consultation incomplete, especially when the revisions proposed will lead to the greatest changes to the levels of private finance that associations are expected to raise since the reform of the grant system in 1989
- .7. We believe that the modelling and analysis of the proposed changes that the SFHA has commissioned demonstrates that many associations will struggle to fund new developments and that in many cases associations with much to offer their communities will be prevented from growing and diversifying as a result of the impact of the proposed changes. The SFHA would encourage the Scottish Government to consider the likely impact of the changes on many associations' ability to develop and grow.

The Scottish Government's Analysis of the Housing Association sector

3.1 The proposals for the revised HAG assumptions are underpinned by analysis of data collected from housing associations. The key findings of this analysis are that:

- Reserves

Housing Associations in Scotland hold substantial free reserves. It is the view of the Scottish Government that in some cases there is scope for these reserves to be used creatively to allow public funds to go further and pay for a greater amount of affordable housing. The SFHA accepts that this may, in some cases, be true. However, several of our members have pointed out that there may be a mismatch between the associations who have substantial free reserves and those who are willing to put reserves into development. It may also be the case that associations with free reserves may not operate in the geographical areas where the Scottish Government wishes to direct investment.

- Rents

Previously, Communities Scotland has assumed that rents would rise in line with inflation. In practice rents have risen at nearly 2% above inflation. The Scottish Government have therefore decided to assume that rents rise at inflation plus 1% over the 30 year life of a scheme. While the SFHA accepts the logic of looking to capture the benefit of these increases in order to ensure



value for money and increase supply, we would urge the Government to be cautious in implementing this approach. Rents may have risen above inflation both to ensure that the SHQS is met by RSLs and in response to rising maintenance costs. These costs were in one case imposed by government and in the other result from the above inflation growth in house prices – neither is within the control of our members. There is a danger that assuming rents rise by above inflation over 30 years could lead to tenants being caught

in a poverty trap and in effect accelerate the residualisation of social housing rather than alleviate it as Firm Foundations proposes to do.

- Operating costs

It has been assumed by the Government that management maintenance and major repairs allowances should be frozen. This is partly because new houses are assumed to be cheaper to manage and partly because the Government has to deliver an efficiencies agenda. The SFHA and its members are keen to work with the Government and accept the need to control costs and maximise value for money. However, the social market makes up an ever smaller proportion of the construction and housing industries and as such our members' ability to keep down costs is limited.

Aims of the Revised Assumptions

- .1. We note that the consultation paper has been developed in order to further the aims of the Scottish Government as outlined in the housing discussion paper, "Firm Foundations" The key aims as summarised in "Better Value from HAG" are:
 - An increased supply of housing across all tenures, all of which is delivered on the basis of higher environmental and design standards
 - More choice of housing that is affordable to those on lower incomes
 - Housing developments that contribute to the creation of sustainable, mixed communities
 - Social housing that provides better value for public expenditure
- .2. The SFHA endorses and supports these aims. We are concerned, however, that the significant increase in the levels of private finance that the proposed revisions would produce may, at least in part, contradict some of the above aims. Modelling of the revised assumptions suggest that HAG levels are likely to drop by 8% and private finance to increase by 30% (see Appendix 1).
- .3. The SFHA has concerns that the aim of delivering higher environmental standards does not square with the drive to lower costs in order to develop more affordable housing for the public pound. In reality, sustainable, quality housing costs more and



the changes proposed are likely to impede progress in raising quality and environmental standards.

- .4. The SFHA believes that the higher rents required to deliver substantial increases in private loans will lead to affordability problems and increase significantly the number of tenants in affordable rented housing who are caught in a Housing Benefit poverty trap. This in turn, will mitigate against the development of balanced, sustainable communities that "Firm Foundations" espoused and that the SFHA fully endorses.
- .5. At the same time the SFHA accepts that there is a need to control costs and ensure value for money.

Impact of the Proposals

- .1. The amount of private finance required for a scheme will increase by between 29% to 44% depending on type of scheme and size of association. As a result, annual interest payments will increase by about 35%.
- .2. This will lead to an increase in negative operational cash flows for new developments, inclusive of an assumption of rents rising 1% above general inflation. Even if the major repairs sinking fund is removed and life cycle costing inserted in its place, cash flows will still be negative.
- .3. While these negative cash flows could be funded using reserves (where possible) this will impact on the ability of housing associations to meet their SHQS commitments.
- .4. In order to support the increased levels of private finance that the revised assumptions would produce, associations would have to change the basis of the valuations that the loans are secured against. Rather than the loans being valued against existing use of stock, they would need to be valued against either existing use with sales or market rent. While some associations already secure loans on this basis and there is an argument that no association house has ever had to be sold, this is a significant issue for many associations.
- .5. The SFHA is very concerned about the impact that the proposed grant appraisal changes will have on the attractiveness of the Housing Association sector to lenders. Housing associations have built up a reputation as a sound low risk investment. We are aware that the Council of Mortgage Lenders (CML) has concerns about the proposals. The CML is worried about the impact that the rent increase assumption of 1% above inflation to year 30 will have on affordability of housing association rents. The CML is questioning whether these increases are sustainable without rents ceasing to be affordable. The CML is also concerned about housing associations' cashflows. Lenders pay more attention to cashflow figures than they do to security and valuation figures. While "cash rich" associations may be able to cross subsidise, "cash poor" associations will struggle to maintain healthy cash balances.



Wider Issues

- .1. The SFHA is concerned about the impact that the proposed changes may have on LSVT associations in particular. We are concerned that the new appraisal system might preclude organisations who have already revised their business plans to meet the SHQS (something not accounted for in their transfer agreements) from continuing to develop. A solely or mainly debt-funded association with low reserves will have two options to cope with the negative cash flows that will result:
 - To take out bank overdrafts, thus increasing the organisation's interest payments further.
 - To shave operational costs to below the allowance levels and / or increase rents beyond 1% above inflation

- .2. Social Enterprise and Wider Action activities are essential in enabling housing associations to contribute to the development of sustainable and well balanced communities. The SFHA welcomes the new Government's commitment to this agenda through developments such as the "Community Benefits in Procurement" Guidance. However, we are concerned that the proposed new grant appraisal assumptions may act as a disincentive for some associations to pursue the social enterprise agenda which the SFHA views as essential to building sustainable communities and promoting equality of opportunity.

- .3. The SFHA believes that there is a danger that the Development Programme will be allocated to those with the most free reserves irrespective of their track record in development.

Conclusion

- .1. The SFHA is concerned that the "Better Value from Housing Association Grant" does not take account of the nature and characteristics of the Housing Association sector and will, in our view, have a detrimental effect on many small to medium sized associations and LSVT organisations. We are keen to work with the Government to promote efficiency and increase supply but we want the Government to recognise that the Scottish Housing Association sector is distinctly different from England. We believe that the consultation paper is flawed because it fails to take account of this uniqueness and proposes too much change too soon.

- .2. The SFHA believes that it is possible to increase efficiency and achieve better value for money while ensuring that the Housing Association sector remains diverse and continues to provide maximum benefit to communities. To achieve this we believe that the Government should look to build on existing examples of good practice such as the Fife and Edinburgh preferred partners models, Devanah in the North East and West of Scotland Housing Association's refinancing arrangement.

- .3. The SFHA is concerned about the likely impact of the proposals for LSVT organisations that already have to meet the SHQS (something not budgeted for in

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their business plans). Many of these associations have a role to play in development that benefits the communities that they operate in, yet they are unlikely to be able to continue to develop under the proposed changes to the assumptions.

- .4. The SFHA believes that the rent growth assumption within the proposals is unsustainable. "Firm Foundations" stated explicitly that social housing should not be the housing of last resort and proposed various initiatives (mid rent, mixed tenure communities, selected sale of stock on failing estates) in order to achieve that goal. The above inflation increases that are assumed by the new assumptions would inevitably encourage residualisation of the sector, if rents ceased to be affordable to workers on low incomes.
- .5. Housing associations have a major role to play in creating sustainable communities through social enterprise, and many of our members have developed initiatives that bring added value to the communities that they serve. The SFHA believes that the proposed changes to the HAG appraisal system could undermine the social enterprise agenda by squeezing association's resources and forcing them to focus solely on their core business. We believe this would be a retrograde step and urge

the Scottish Government to continue to support the SFHA and its members as we take forward the social enterprise agenda in our communities.

SFHA

25 March 2008

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HAG Financial Appraisal Comparison between existing and proposed assumptions

Section 1. Key Inputs set by Association		
Example	CSGN 2007/06 Updated	
Type(New Build or Rehab)	New Build	
No of Units in scheme	10.00	
No of Units in ownership	550.00	
Scheme Costs	Per Unit	Total
Works	95,000.00	950,000.00
Other Costs	20,000.00	200,000.00
Total Scheme Costs	115,000.00	1,150,000.00
Annual Rental Income per unit	2,700.00	27,000.00

Section 2. Key Outputs	Present Assumptions			Proposed Assumptions		
	%	Per Unit	Total	%	Per Unit	Total
Private Finance	21.34%	24,539.25	245,392.54	28.95%	33,291.26	332,912.61
Housing Association Grant	78.66%	90,460.75	904,607.46	71.05%	81,708.74	817,087.39
Total Scheme Costs	100.00%	115,000.00	1,150,000.00	100.00%	115,000.00	1,150,000.00
				% change in PF	35.67%	
				% change in HAG	-9.67%	

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Section 3. Key Inputs set by Communities Scotland

	Present	Proposed - Costs	Proposed - Income
Long Term Interest Rate	6.00%	6.00%	6.00%
Inflation Rate	2.50%	3.00%	4.00%
No of Years	30	30	30
PF Factor	18.13692	19.24630	21.76458
Real Interest Rate	3.61%	3.14%	

	Present	Proposed
Real Rent Increase	0.00%	1.00%
Voids Rate	2.00%	1.00%

Management Allowances per unit

Units in Association ownership

From	To	
0	250	384.00
251	500	351.00
501	1000	333.00
1001	2500	312.00
2501	5000	291.00
5001		270.00

Maintenance Allowances per unit

New Build	450.00
Rehab	782.00

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Major Repairs	
	% of Works
New Build	0.80%
Rehab	0.90%
Maximum per unit	
New Build	510.00
Rehab	573.00

Section 4 Detailed Workings					
		Worked Example in CSGN			
Example		2007/06			
Type		New Build			
Scheme Units		10.00			
Association Units		550.00			
		Present Assumptions		Proposed Assumptions	
		Per Unit	Total	Per Unit	Total
Capital Costs					
A	Works	95,000.00	950,000.00	95,000.00	950,000.00
B	Other Costs	20,000.00	200,000.00	20,000.00	200,000.00
C	Total Capital Costs	115,000.00	1,150,000.00	115,000.00	1,150,000.00
Annual Income					
D	Rental Income	2,700.00	27,000.00	2,700.00	27,000.00
E	Voids	54.00	540.00	27.00	270.00
F	Rents less Voids (D-E)	2,646.00	26,460.00	2,673.00	26,730.00
Annual Costs					
G	Management	333.00	3,330.00	333.00	3,330.00
H	Maintenance	450.00	4,500.00	450.00	4,500.00
I	Major Repairs	510.00	5,100.00	510.00	5,100.00
J	Total Annual Costs (G+H+I)	1,293.00	12,930.00	1,293.00	12,930.00
K	Net Rental Income (F-J)	1,353.00		1,380.00	

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	Income Factor	18.13692		21.76458	
L	Present Value of Income over 30 years (F X L)	47,990.29	479,902.93	58,176.73	581,767.27
M	Cost Factor	18.13692		19.24630	
N	Present Value of Costs over 30 years (J X N)	23,451.04	234,510.39	24,885.47	248,854.66
O	Private Finance (M-O)	24,539.25	245,392.54	33,291.26	332,912.61
P	Housing Association Grant (C-P)	90,460.75	904,607.46	81,708.74	817,087.39
Q	Total Funding (P+Q)	115,000.00	1,150,000.00	115,000.00	1,150,000.00
R	Private Finance %	21.34%	21.34%	28.95%	28.95%
	HAG %	78.66%	78.66%	71.05%	71.05%
				% change in PF	35.67%
				% change in HAG	-9.67%
		%	maximum	%	maximum
	Major Repairs	0.80%	510.00	0.80%	510.00