



## The End of Local Control?

### GWSF Briefing on the Scottish Government's Proposals for Investing in Affordable Housing in Scotland

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## Executive Summary

1. Glasgow and West of Scotland Forum of Housing Associations (GWSF) has represented community-based housing associations (CBHAs) in Glasgow and the West of Scotland for more than 30 years. This Briefing informs our members about the Scottish Government's Consultation Document "**Investing in Affordable Housing**", and the issues it raises for locally controlled housing associations in Scotland.
2. The Consultation Document makes some changes to the initial proposals for investment reform that were set out in "Firm Foundations" in 2007. But the essential features of the latest proposals are still that:
  - Responsibility for delivering development programmes should be concentrated increasingly in the hands of a relatively few organisations ("Lead Developers");
  - Funding should be awarded through regional competitions.
3. The Lead Developer approach is the Government's preferred option for the future. Single housing associations or housing associations working in development consortia would also be able to bid for funding – but with several catches in the small print:
  - These alternatives may only be available until the Lead Developer approach becomes fully established;
  - The share of available funding to housing associations not working as part of Lead Developer arrangements would be progressively reduced;
  - Only Lead Developers would be eligible for longer-term funding agreements.
4. These factors may prevent resources for new housing being directed to where they are needed most. They will limit the ability of other housing associations and/or development consortia to achieve the best value for public funds. And they will stand in the way of providing the longer-term certainty that the construction industry needs.
5. We do not share the Government's view that the current financial and economic climate justifies the particular approach it has proposed. Along with the flawed guidance on Housing Association Grant (HAG) financial appraisal issued in April 2008, the solutions now proposed will **reduce rather than enhance** the capacity of housing associations to accelerate the construction of new housing.
6. The Consultation Document is based on the speculative assumption that specialisation and competition are the key to greater efficiency. At the end of this Briefing, we have set out some practical measures that would help achieve better value for the use of HAG, in the unprecedented economic circumstances that currently prevail.

7. Scottish housing associations are already moving away from delivering their own individual development programmes in every case. Most associations – particularly those with smaller-scale programmes or with limited in-house resources or expertise - recognise that partnership working with others can provide mutual benefits.
8. The Government's proposals will not harness this potential, because they are based on a prescriptive and inflexible approach to partnerships. The proposals would reduce the control that non-developing housing associations (i.e. the vast majority) can exercise over housing for which they will have long-term responsibility. The proposals would also diminish accountability to local communities in a way that is odds with the Government's approach in other policy areas. A more flexible and permissive approach to the forms that partnerships can take is essential, along with recognition that funding of individual housing associations should be also part of the Government's long-term strategy, in a range of circumstances.
9. We have sent copies of this Briefing Paper to all Scottish housing associations, and to Scottish Ministers and other elected politicians. We encourage all of our members to respond individually to the Consultation Document, stressing the need for the Government to refocus its approach and to adopt the proposals GWSF has made in this Briefing Paper.
10. GWSF will be seeking early discussions with Ministers in the Scottish Government on the action that needs to be taken immediately. We hope that the Briefing Paper will help inform debates in the Scottish Parliament and questions to the Government.

**Glasgow and West of Scotland Forum of Housing Associations  
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## 1. The Context for Investment Reform

**1.1** On 9 December 2008, the Scottish Government published “Investing in Affordable Housing: A Consultation”. The deadline for responses is 17 March 2009.

**1.2** The Consultation Document develops the ideas first set out in “Firm Foundations”<sup>1</sup>, in which the Government:

- Stated that the existing subsidy system for investment in affordable housing was producing poor value for money;
- Proposed the introduction of regional competitions for Housing Association Grant (HAG), based on the lowest amount of grant required;
- Proposed that all future investment funding would be channelled to a small number of “Lead Developers”, with a single Lead Developer in each region.

**1.3** The investment reform proposals contained in “Firm Foundations” were poorly received by housing associations and others.<sup>2</sup> Many respondents, including GWSF, suggested other methods for getting the best value from housing investment.

**1.4** In June 2008, the Deputy First Minister told Parliament that the Scottish Government remained committed to “a more strategic and competitive approach” to housing investment, but recognised that this “...could be done in a variety of ways”. The Deputy First Minister said the Government would “explore all the options before deciding on the form that the new system will take”.<sup>3</sup>

**1.5** The results are set out in the new Consultation Document. The essential features proposed in 2007 (regional competitions and Lead Developers) remain. The promised review of options has been limited to adapting the detail of the approach described in “Firm Foundations”, rather than examining genuine alternatives.

**1.6** The proposals have been developed against the backdrop of the global financial crisis and the onset of economic recession. So the need for coherent, effective policy solutions could not be more urgent. The investment reform proposals should also be viewed alongside the new HAG financial appraisal assumptions, introduced by the Government in April 2008.<sup>4</sup> We return to both themes later in this Briefing.

## 2. Summary of Consultation Document Proposals

**2.1** The main proposals set out in the Consultation Document are shown below:

An overview of the Consultation Document proposals
<b>Investment Priorities</b> <ul style="list-style-type: none"><li>• The Government would set investment priorities on a regional basis.</li><li>• Each region would cover several local authority areas, except for Glasgow and</li></ul>

<b>An overview of the Consultation Document proposals</b>
<p>Edinburgh which would each be regions in their own right.</p> <ul style="list-style-type: none"> <li>• Investment priorities would be agreed between the Government and local authorities.</li> <li>• There would be separate arrangements for Orkney, Shetland and the Western Isles.</li> </ul>
<p><b>Regional Investment Prospectuses</b></p> <ul style="list-style-type: none"> <li>• Investment priorities for each region would be set out in Prospectuses, which would take account of local authorities' Strategic Housing Investment Plans.</li> <li>• The Prospectuses would be produced following consultation with local authorities, and would serve as an invitation for housing associations to bid for HAG.</li> <li>• The Prospectuses would specify maximum rent levels for new houses. This means that rents would effectively be set by the Government (or local authority grant provider).</li> </ul>
<p><b>Lead Developers</b></p> <ul style="list-style-type: none"> <li>• Lead Developers would operate within each region.</li> <li>• There could be more than one Lead Developer per region.</li> <li>• Lead Developers are organisations to which the Government intends to direct <b>the majority of future investment funding</b>.</li> <li>• In return, the Government would expect Lead Developers to provide “ a more specialist and skilled approach to managing assets, finances and development for the benefit of the sector as a whole”.</li> <li>• Lead Developers would finance and develop new housing on their own behalf and/or for other housing associations, which would purchase completed houses from the Lead Developer.</li> </ul>
<p><b>Development Consortia</b></p> <ul style="list-style-type: none"> <li>• RSLs would be encouraged to form development consortia that are “committed to securing greater efficiency and more value from the investment in affordable housing”. This would be a first step towards one of the associations in the partnership applying to become a Lead Developer in future.</li> <li>• It would also appear that development consortia could apply for funding, even if one of the partners does not intend to seek Lead Developer status. But longer-term funding agreements would not be offered by the Government in these circumstances.</li> <li>• In all cases, a consortium would be led by <b>one housing association</b> which would bid for subsidy on behalf of the consortium as a whole. The lead housing association would be responsible for contracting and procurement and for ensuring the quality of the housing to be built.</li> <li>• The Consultation Document advises housing associations not currently working in a consortium to either join a consortium or set one up.</li> </ul>
<p><b>Bidding for HAG</b></p> <p>There would be a two stage process for bidding for HAG:</p>

### An overview of the Consultation Document proposals

- Housing associations wishing to obtain grant for housing investment would apply to be assessed against pre-qualification criteria. Pre-qualification is a proposed new test, to decide whether a housing association should be eligible to bid for HAG at all.
- If a housing association achieves pre-qualification, it would move on to the second stage (bidding for subsidy in competition with others, and/or seeking to be appointed as a Lead Developer).
- Pre-qualified housing associations could compete for subsidy for “short term costed projects”, acting on their own behalf or as the head of a consortium made up of a number of housing associations.
- Pre-qualified housing associations could also seek appointment as a Lead Developer, which would offer the possibility of a “conditional guarantee” of funding for up to 5 years.

Subsidy would be awarded to those projects that “offer the most competitive price and best match the funding criteria”. Future rounds of competition for subsidy would be conducted “as and when necessary, bearing in mind that, where Lead Developers have been appointed, much of the Investment Programme may already have been committed to them”.

## 3. Three Routes to HAG Funding

**3.1** In “Firm Foundations”, the Lead Developer option was the only way of seeking HAG. The major change in the Government’s thinking is that in the short term, there would be **three possible routes** to obtaining HAG for new housing. These are Lead Developers, development consortia, and single housing associations bidding for HAG. In this section, we examine the practical implications of each of the three funding routes, and suggest how the Government’s proposals should be revised.

**3.2** The change in approach that is now proposed is welcome. But this is tempered by concern that Lead Developers are the Government’s preferred option for the future, and that funding for the other two routes will reduce progressively when Lead Developers are appointed. Alternatively, the other two routes could provide a “get out of jail card” if (as many senior development practitioners predict) the Lead Developer arrangements cannot be implemented for practical reasons.

### Option 1: Lead Developers

#### Key issues for locally based housing associations

**3.3** The proposed introduction of Lead Developers would concentrate control and delivery of development programmes in a single organisation, with locally based housing associations unable to compete on equal terms with larger organisations operating across wider areas. Other housing associations could work with a lead developer, but would purchase completed housing from the Lead Developer instead of developing the housing themselves. Of the three funding routes on offer, only Lead Developers would have access to longer term funding agreements.

**3.4** The Government is clear that it wishes to see a substantial reduction in the number of developing housing associations in future. Access to longer-term funding agreements is the major incentive on offer to prospective Lead Developers. But the Consultation Document does not address the risks associated with being a Lead Developer, why housing associations would be prepared to take on these risks on behalf of other organisations, whether they would be legally able to do so, or under what circumstances they could transfer risks such as increased capital costs on to purchasing housing associations. The housing and charities regulators will need to offer guidance on the risk management and transfer issues raised by the Consultation Document.

**3.5** Locally based housing associations have a proven track record in delivering well-targeted, sustainable investment at local level. This is recognised at the start of the Consultation Document, but is not reflected in the proposals that follow in the rest of the Document. In reality, the role of locally based housing associations would be greatly reduced under the Lead Developer approach to funding that has been proposed.

**3.6** For those that do choose to work with a prospective Lead Developer or consortium, there is the risk of joining the “wrong consortium”. It is possible that no investment could take place in a particular area, if a locally based association joins a consortium whose leader then fails to be appointed as a Lead Developer.

### **The suggested benefits of the Lead Developer approach**

**3.7** The Government has suggested that its proposals will bring substantial benefits, in comparison with the current approach to housing investment. These benefits are presented in very broad terms. They include, for example: ““better coordination and application of resources””; “more sophisticated and robust approaches to funding projects and managing development cashflow””; “increased economies in the investment and procurement functions””; and “stronger asset management”.

**3.8** It is unclear what these statements mean, in practical terms. For example, who would employ development staff; how projects would be funded while they are being built; the financial basis of transfers upon completion and the risk management and transfer framework that would apply. Nor does the Consultation Document state what baseline information would be used to measure “better”, “more”, “stronger” etc., or what specific measures the Government would use to assess the outcomes delivered by the overall policy or by Lead Developers.

**3.9** The Consultation Document offers no substantive guidance on some critical legal issues raised by the proposals:

- Is the proposed approach to competition – including the proposal to offer additional grant after the initial period of a Lead Developer’s appointment - competent in terms of EU procurement directives?
- Is the suggested role of Lead Developers in “the better coordination and application of available resources” consistent with the legal independence and obligations of each RSL working with a Lead Developer, for example in relation to charity law?

- What issues will arise in terms of employment law, in particular TUPE, where one of the Lead Developer's partners already employs development staff?

### **Will the introduction of Lead Developers result in greater efficiency?**

**3.10** Recent independent research from England<sup>5</sup> (where a more flexible model has operated since 2004) offers the following conclusions:

- The main savings achieved have been from management overheads, rather than from lower procurement costs;
- Lower procurement costs are more likely if housing associations combine their development programmes **and** if this is linked to longer-term funding agreements;
- There is potential for lower procurement costs through the adoption of shared design and technical standards, and generating the scale of programmes needed to make greater use of Modern Methods of Construction, in areas where an element of standardisation is both desirable and feasible.
- A wide range of partnership models can deliver the right results.

**3.11** The key point is that the potential for efficiency stems from **collaboration linked to longer-term programmes**, rather than from the designation of a Lead Developer or concentrating all aspects of development delivery and financing in a single organisation.

**3.12** The process of competition that is proposed will make it difficult to judge whether efficiency is being achieved or not. Bids are likely to vary widely in terms of their scale and standards. The requirement that bids must be based on "specific, costed proposals" will also lead to inefficiency. Most development professionals would interpret this requirement to mean that a cost plan should have been produced. Multiplied by the number of projects that might be covered by a bid, this will lead to high levels of abortive costs for those organisations whose bids fail. There will be a perverse incentive for bidding organisations to weight their bid costs, to take account of the risks of failure.

**3.13** Competition leading to the appointment of Lead Developers is unlikely to be the "magic bullet" that the Consultation Document envisages. A model based on challenging effective developers to demonstrate continuous improvement in quality and cost-effectiveness would have been preferable.

### **The role of Lead Developers and consortium heads**

**3.14** The Consultation Document provides an outline specification of the main responsibilities of Lead Developers and housing associations heading up development consortia. These are described as being leadership; contracting and procurement; ensuring quality; receiving and being accountable for all grant payments; and, in the case of Lead Developers, promoting greater standardisation in process and product and working with local planning authorities.

**3.15** Other, non-developing housing associations would still be able to add to their housing stock. But they would do this by “... joining a consortium and working with the head of the consortium or Lead Developer to provide the new houses on their behalf”.

**3.16** The Consultation Document states that non-developing housing associations will be able to “help inform” the Lead Developer’s plans and timescales; to “advise” the Lead Developer on build and quality specifications; and to “input” to a consortium’s overall contracting and procurement strategies. This means that:

- Non-developing associations would be **consulted** about the housing to be developed in their communities, for which they will have long-term asset management responsibilities, but
- **Control** over these matters would rest with Lead Developers or consortium heads.

**3.17** This aspect of the proposals will reduce community accountability, and create increased long-term risk for ownership housing associations. It is completely at odds with the values, traditions and successes of most of the Scottish housing association sector.

### **Option 2: Development consortia**

**3.18** The Consultation Document raises the possibility of housing associations forming partnerships with each other to bid for investment funding. The main features of the proposed model are that:

- The partner housing associations would need to designate one of their number as the head of the consortium.
- The consortium head would bid for funding on behalf of all of the partners.
- Only the consortium head would be eligible to receive grant.
- Other housing associations in the consortium would purchase completed housing from the consortium head, as under the Lead Developer arrangements.
- Consortia would only be eligible to receive funding for short term, costed projects. The consortium would only become eligible to receive longer term funding agreements if its head was subsequently appointed as a Lead Developer.

**3.19** As with the Lead Developer option, the major weakness is that a single housing association must always develop new housing on behalf of its partners. The same concerns about risk, financing and employment relationships arise, as with the Lead Developer approach.

**3.20** The Consultation Document sets out a range of issues to be considered in setting up development consortia. The assumptions made about timescales do not reflect the complexities involved in forming strategic partnerships, and much of the content raises immediate questions about “why” and “how”. For example, the Consultation Document suggests that:

- Housing associations can be members of more than one consortium – a well-intentioned suggestion, but one which is impractical and will create additional costs and inefficiency;
- Members of a consortium will mutualise financial resources and risk management, in ways that are implied rather than clearly explained;
- Members of a consortium will need to have “a consistent approach to raising and managing finance”, again for reasons that are not clearly explained in terms of the purpose or the practicalities involved.

**3.21** Failure to join up broad principles with the realities of delivery is a major cause of policy failure in public services. More than a year on from “Firm Foundations”, much more detail is needed about the practicalities of delivery. The Consultation Document rightly states that there should be flexibility about the formation and operation of development consortia. But there is a strong sense that policy-makers do not know how a consortium approach would work in practice, and intend to pass on the challenge of finding workable solutions to housing associations.

**3.22** The Consultation Document proposes that the head of a consortium must be a housing association. At this stage, the Government’s view is that non-registered development vehicles formed by a number of housing associations should **not** be eligible to receive funding, but it has invited views on this option. This option is likely to be attractive to locally based housing associations wishing to work together in partnerships of equals, and to spread rather than concentrate exposure to risks. While there is only one precedent for the formation of such a non-registered vehicle in Scotland, their use has been permitted in England.

### **Alternative approaches to creating successful strategic development partnerships**

**3.23** There is considerable interest among Scottish housing associations in working in partnership with others on development programmes. Many associations already do this, by sharing staff resources and expertise as well as through strategic development partnerships. With the growth in these arrangements, the sector is already moving away from the idea that the only way to deliver development programmes is for every single housing association to be directly responsible for all aspects of management and delivery.

**3.24** While the Government has recognised this potential, its proposals involve a restrictive approach in which there must always be a single, dominant partner.

**3.25** While some housing associations may choose to enter into the kind of arrangements described in the Consultation Document, this should not be the only option available. Enforced partnerships in which there is an inequitable balance of influence and control are unlikely to deliver greater efficiency. They will also have inherent tensions, which will de-stabilise partnerships and the governance of their individual members.

**3.26** These concerns would be alleviated if housing associations were permitted to form strategic partnerships with others of their own choosing to deliver collective programmes on terms that are acceptable to the partners. This would remove (or at least make more manageable) many of the practical difficulties involved. For example, in relation to community involvement and accountability; ensuring that control over project briefs and quality standards remains with the future owner of the housing; employment relationships; funding and transfer mechanisms; building contracts; and the spreading and effective management of risk.

**3.27** Roles within a strategic partnership should be determined by the partners, and could include:

- A lead housing association for programme management and co-ordination purposes
- Other developing housing associations within the partnership
- Non-developing housing associations, whose development programmes would be delivered under genuine partnership working with either the lead housing association or another developing housing association.

**3.28** Under this approach, non-developing housing associations would not be downgraded to a secondary or passive role in the overall process. Grant allocations would continue to be in the name of the future owner of the stock, which would also have control over the brief, housing mix, and the quality standards to be delivered.

**3.29** Insisting that a single RSL must develop and then sell completed housing to other housing associations in every case is too prescriptive. The research quoted earlier on development partnerships in England cautioned against a “one size fits all” approach. This is an important source of evidence, since it is based on real experience. Closer to home, there are examples of successful strategic development partnerships (for example, the Rowan Group in Edinburgh) where the partners’ roles and responsibilities have been agreed in a much more flexible way than is being proposed in the Consultation Document.

### **Option 3: Individual housing associations continuing to seek HAG in their own right**

**3.30** The Consultation Document allows for the possibility of individual housing associations receiving HAG for their own development programmes, but suggests that this would only be a temporary measure until the Lead Developer approach becomes fully established. Under the Consultation Document proposals:

- A housing association would have to meet pre-qualification criteria to compete for HAG, and then the cost/funding criteria set at the second stage of competition.
- Grant approval would be restricted to short term, costed projects, and longer term funding agreements would not be on offer.
- If Lead Developers were appointed and received long-term funding agreements, the share of resources potentially available to single housing associations would reduce in future.

**3.31** There is a strong case for a continued role for individual housing associations in delivering development programmes, alongside other approaches based on partnership working. Scotland's locally based housing associations cannot bear high levels of risk on behalf of other organisations, nor is it appropriate for them to be asked to do so. But a number are among the most innovative and effective developers in the country.

**3.32** The current proposals risk losing this expertise and the wider benefits that locally based organisations bring to the building of new homes. It is not difficult to arrive at options that would secure a continued role for excellent individual developers, within an overall framework in which there are fewer developing housing associations overall. For example, the pre-qualification process the Government has described could serve as a system for accrediting the most effective developers, to ensure that these have a continuing role to play, whether as individual organisations or in partnership with organisations that do not have an equivalent track record of expertise.

**3.33** It is also important to allow for the long-term continuation of single housing association programmes for very practical reasons. For example:

- In large-scale regeneration projects, a procurement and development strategy focused on each regeneration area is the most sensible approach.
- It will still be necessary to allow for the possibility of more bespoke designs on sites of strategic importance.
- The construction of some types of new housing for people with particular needs requires may require specialist expertise, rather than generic development skills.
- The scale and practicalities of making collaboration work are likely to be very different in urban and rural contexts.

## **4. Weaknesses in the Government's Case for Investment Reform**

### **Financial uncertainty and problems in the construction sector and home ownership markets**

**4.1** During 2008, house building in Scotland has been severely affected by the global financial crisis, and the UK economy has entered a period of recession. In August, the Scottish Government announced measures to address the problems created by the financial crisis. These measures included accelerating £100 million of planned investment in new affordable housing during 2008/09 and 2009/2010, to help meet housing need and safeguard construction jobs and skills<sup>6</sup>.

**4.2** In his response to the UK Chancellor's Pre-Budget Statement, the Cabinet Secretary for Finance and Sustainable Growth recently re-affirmed the Government's commitment to supporting further acceleration of capital and infrastructure projects – including housing and regeneration – to help keep the economy moving and provide support for construction sector jobs.<sup>7</sup> If this is the Government's overriding priority, making fundamental changes to the current systems for delivery at the present time

needs to be based on proven solutions and a rigorous assessment of the risks involved. But the Consultation Document provides no meaningful information about the evidence on which the proposals are based, nor is it clear what kind of risk assessment the Government has carried out.

**4.3** It had been anticipated in many quarters that the Government might delay its plans for investment reform, so that it could give undivided attention to accelerating the housing investment programme at a time when construction jobs are under severe threat. For example, the Government has so far allocated only £18 million of the £100 million accelerated expenditure announced in August, which is due to be spent by March 2010. Some of the funding already allocated will be used to fund off the shelf purchases of unsold houses that have already been built. So there is still a great deal to do to meet the aim of safeguarding construction jobs and skills.

**4.4** The Consultation Document states, "... the financial and economic situation strengthens, rather than reduces the need for investment reform". It notes that in the future there will be a more challenging lending environment for housing associations and adds (far more controversially) that "... this aligns with our proposals for selecting Lead Developers".

**4.5** In fact, the Government's proposals will concentrate financial risk, which is highly undesirable in the current climate. If the Consultation Document proposals are seen by lenders as increasing risk, the result may well be to intensify the difficulties caused by the present shortage of credit and/or higher lending margins.

**4.6** The proposals would concentrate ownership of land and contractual liabilities in the hands of a single housing association. As recent events in England have shown, very large land banks carry high levels of financial risk if land values reduce. The Chief Executive of England's new housing regulator (the Tenant Services Authority) has told the Westminster Parliament<sup>8</sup> that some English housing associations are facing the risk of insolvency, because of write-downs in the value of their land banks. In view of the present unpredictability of financial markets, the Scottish Government should **limit rather than concentrate** levels of financial risk in individual housing associations.

**4.7** Lenders' views in other parts of the UK offer further perspectives. For example, Lloyds TSB has recently predicted growth in **smaller lending packages** to housing associations.<sup>9</sup> This is because large-scale loans will be scarcer in future, and smaller housing associations will often represent a lower risk (for example, they will often be less highly exposed and geared than larger or more complex organisations).

**4.8** We know from Wales that groupings of independent housing associations have jointly gone to the market to raise much larger sums of private finance on more competitive terms than would otherwise have been possible. They have done so without compromising their independence, or mutualising their liabilities or risks. These kinds of innovative approaches could be considered for Scotland, and would encourage the lending institutions to play their part in contributing to greater efficiency.

**4.9** The view that larger-scale lending and greater concentration of treasury management functions are desirable is not proven. It will involve real financial risks to housing associations and their tenants. The proposals set out in the Consultation Document do not reflect these risks and realities.

#### **How new housing is funded: changes made by the Government to HAG financial appraisal**

**4.10** In April 2008, the Scottish Government published new guidance on HAG financial appraisal assumptions.<sup>10</sup> These assumptions determine the amount of HAG for new developments. The Scottish Federation of Housing Associations has estimated that the new measures will increase the amount of private finance needed for development projects by up to 44%.<sup>11</sup>

**4.11** The appraisal assumptions have already been implemented (despite very strong opposition), and their impact is closely linked to the current proposals. The appraisal assumptions will determine whether individual housing associations can afford to continue to provide new housing, whether they develop this themselves or whether they purchase newly completed housing from others.

**4.12** The HAG appraisal measures have coincided with the global financial crisis, obliging housing associations to seek higher levels of borrowing, at a time when new loans are harder and more expensive to obtain. Across Scotland, many associations are reporting that some developments cannot be fully funded by a combination of HAG and private finance based on the tenanted value of the houses to be built. Some of our members have reported that applying the new assumptions can result in proposed new developments showing annual deficits for 20 years after the date of construction.

**4.13** As a result, housing associations are having to look at other sources to bridge the gap, for example:

- Use of reserves set aside for future major repairs. This option is only available if reserves on a balance sheet are cash-backed, which they often are not.
- Use of other housing assets to provide additional security for borrowing. This could provide lenders with an opportunity to seek to re-price existing loans.
- Higher rents (albeit the Consultation Document proposes a direct role for Government in rent-setting).
- Use of higher risk types of borrowing or financial instruments.
- Using sales proceeds from home ownership to cross-subsidise new housing for rent.

**4.14** Some of these options may be feasible for individual housing associations, depending on their particular financial profile. But none of them provide sustainable, long-term solutions for the sector as a whole. The HAG appraisal guidance fails to

recognise the complexities and the risks involved, and offers a simplistic “one size fits all” solution, to be applied in every set of circumstances. It is worth reinforcing that:

- Housing associations are non profit making enterprises with a social purpose;
- Their assets are tenants’ homes;
- The new guidance will oblige housing associations to take higher risks with their assets, if they wish to continue to build or acquire new houses for the benefit of current and future tenants.

**4.15** The effects of the new guidance have been discussed regularly at GWSF events throughout 2008. Without exception, our members have expressed their concerns in the strongest possible terms, and we call on the Government to withdraw the guidance.

**4.16** The introduction of the new HAG appraisal assumptions, linked to the overall investment reform proposals, evokes worrying comparisons with the funding regime that has operated in England since 2004. We know from recent events in England that some housing associations are facing severe financial difficulties because of aggressive re-pricing of existing loans by lenders, and/or unaffordable cash calls by lenders to housing associations that have purchased interest-rate swaps, and/or pressure to subsidise the provision of new rented housing from building for sale on a large scale.

**4.17** Most Scottish housing associations have taken a much more prudent approach to risk exposure. The smaller scale of Scottish housing associations means that participation in high-risk development activities and trading in financial instruments is minimal in comparison with England. But Scottish housing associations will come under increasing pressure to take financial risks if they want to build or purchase new houses to meet housing need – or be excluded from providing new housing.

**4.18** The Scottish Housing Regulator<sup>12</sup> has recently written to housing associations, referring to the changes to HAG appraisal assumptions and the Government’s wider proposals for investment reform. The Regulator has not offered any comment on the merits of the Government’s policies, but it is clear that it sees both sets of measures as having the potential to increase housing associations’ risk exposure.

### **The lack of evidence and transparency**

**4.19** The Government has not published any detailed evidence in support of the specific measures it is proposing. This is a basic principle of effective and accountable policy-making. The absence of evidence means that many will continue to be sceptical about how the proposals will address the root causes of increasing subsidy levels.

**4.20** Calls for greater transparency about evidence were a prominent feature of the “Firm Foundations” consultation report published by the Government.<sup>13</sup> While the Government has not published any factual analysis, others have done so. Independent research published by the Scottish Federation of Housing Associations earlier in 2008<sup>14</sup> noted that the most significant cost drivers in the cost of new affordable housing were land value and availability, land remediation costs, and the amount of remediation work

required on brownfield land. The Consultation Document does not address these systemic factors and focuses much more narrowly on investment processes, in particular which organisations should receive funding, and how they should be selected.

**4.21** The Government's views about a failing investment system are not borne out by the most recent independent evaluation of HAG in Scotland.<sup>15</sup> The main author of that report has recently commented<sup>16</sup> on the need to challenge the evidence for the view that larger organisations develop more efficiently than smaller ones. He voiced concern that in the absence of firm evidence, the Government risks "sacrificing one of the most effective approaches to community development Europe has seen in the past 30 years" (i.e. the work of locally based housing associations in building houses to meet community need, in both urban and rural Scotland).

**4.22** The consultation period runs until the middle of March 2009. GWSF calls on the Government to show its commitment to transparency and policy-making based on evidence, by making public the evidence base on which its proposals are based.

**4.23** The following information would be particularly useful:

- The Government's analysis of the problems which the proposals are intended to address and their underlying causes;
- The evidence that is available to show that the current proposals will address these problems and their underlying causes;
- What analysis has been carried out to assess how the proposals will affect the delivery of affordable housing in different contexts (for example, urban regeneration areas, rural communities, pressured areas);
- The available evidence on current physical quality standards being achieved, and whether the Government's own funding practices are enhancing or restricting physical and sustainability standards;
- A more detailed account of the stakeholder events led by Government officials in summer 2008. The one-page summary at the end of the Consultation Document is an unsatisfactory way of recording the views and contributions made by large numbers of housing associations and local authorities throughout Scotland.

#### **A more strategic approach to investment?**

**4.24** One of the Government's main aims is to improve how strategic priorities for housing are identified and then delivered. We acknowledge the considerable amount of new guidance the Government has published to help achieve this, and we agree that Local Housing Strategies should be the focus for articulating strategic investment priorities, and for these to be reflected in the regional investment Prospectuses the Government intends to introduce. But this will only be fully effective if the Government itself sets much clearer strategic priorities for the use of HAG.

**4.25** Neither the Consultation Document nor any other current guidance provide an up to date answer to the critical question, “**What is HAG for?**” Since Government spending on affordable housing is around £500 million each year, this should be at the heart of any discussion about affordable housing and how the use of public funds should be prioritised. It is simplistic to assume that Local Housing Strategies and the accompanying Investment Plans will address these questions in a consistently meaningful way. As the primary funder of affordable housing, the Government needs to provide a much stronger lead on key questions, for example how regeneration should be balanced against meeting shortages of affordable housing.

**4.26** The need to re-consider the aims of HAG was highlighted in the most recent independent evaluation of HAG published in 2005. But policy objectives and targeting criteria for HAG have not been revised to take account of this, nor do we have up to date evaluations about the impact of different types of investment.

**4.27** The Consultation Document suggests a possible geography of the regions in which funding competitions would take place, but states that this will be reviewed after further consultation. The suggested regional geography is difficult to understand, based on how housing market areas, regeneration or the construction industry work. It is unclear how basing investment decisions on such large-scale and often disparate regions will contribute to more strategic decision-making or greater efficiency. Nor is it clear how local assessments of need at community level can be reflected in the overall process. The Government’s thinking on regional prospectuses is still at a formative stage. But drawing together the investment priorities of a large number of local authorities in a single place will be a complex (and potentially politicised) process.

**4.28** The Government has suggested that the introduction of very large-scale regions is necessary to realise potential economies of scale. But few housing associations are likely to be willing or able to operate over such large spatial areas. While the Consultation Document states that there could be more than one Lead Developer or consortium in a given region, no information about the required scale of programmes is given. Since it is possible that programme value thresholds could be used as a reason for rejecting future bids or pre-qualification applications, an early statement of future intentions by the Government is essential.

### **The costs of implementing the Government’s policy proposals**

**4.29** The investment reform proposals will require a major input of resources on the part of central government, local authorities and housing associations. Since efficiency is a key driver for the proposals, we are interested in establishing what assessment the Government has made of the overall costs of implementation. This is not addressed in the Consultation Document.

### **Restrictions in the use of longer term HAG funding agreements**

**4.30** The Government’s intention of providing clearer statements of future priorities and promoting longer-term planning and funding periods are welcome. Longer-term

funding is widely agreed to be **the single most important factor** in realising the potential for more efficient delivery of development programmes. But longer-term funding agreements will only be on offer to Lead Developers. This is a missed opportunity, since it will greatly restrict the ability of other housing associations to develop more efficiently.

#### **The lack of information relating to physical quality standards and sustainability**

**4.31** The Government has stated its commitment to promoting physical quality and sustainability. But the Consultation Document says very little about how this will be achieved, beyond some general references to building regulations and SPP6. As stated in our response to “Firm Foundations”, GWSF believes that the Government should develop national quality standards. These are an integral part of housing investment systems in both England and Wales, but no work appears to have been carried out to provide a similar framework for Scotland.

**4.32** Otherwise, it is unclear what incentive Lead Developers will have to incorporate quality features that will deliver long-term benefits to either the future owner of the housing and/or tenants, if the costs of innovation or higher standards will reduce the competitiveness of a bid or will involve higher capital costs during the development period.

#### **The lack of information on the Transfer of Management of Development Funding (TMDF) in Glasgow and Edinburgh**

**4.33** The Consultation Document states that the city councils in Glasgow and Edinburgh will continue to award HAG subsidy, “...adopting approaches which are in accordance with the agreed competitive arrangements”. It is not clear what this means. TMDF is dealt with in a single sentence, with no sense of what the Government will do to review the current TMDF agreements or procedures. Since a very large share of the national programme is spent in the two cities, the lack of information is a serious weakness. It will prevent housing associations in both cities from being able to plan effectively for a new approach to housing investment.

### **5. Shared Aims and Objectives: Producing More Affordable Homes for Less Subsidy**

**5.1** The Government’s overall aim is to produce more housing, to higher environmental standards, while ensuring good value for money for the taxpayer. GWSF members wish to contribute to achieving these aims, in common with housing associations throughout Scotland.

**5.2** We are concerned that the investment reform proposals divert attention from the top priority of delivering the maximum number of homes to meet housing need, during a period of financial instability and economic recession.

**5.3** In these circumstances, we suggest that the Government should re-focus its efforts. These are our proposals for immediate action by the Scottish Government, working in partnership with housing associations and local authorities:

- Immediate introduction of longer-term funding agreements, linked to agreed programme outcomes, to enable housing associations to plan and deliver more effectively and to provide increased certainty for construction industry partners.
- Enabling housing associations to buy land now, to take full advantage of current market conditions and reduce future subsidy levels.
- Maximising the disposal of public land to housing associations at nil value, where such opportunities exist (for example, cleared sites in Glasgow formerly occupied by GHA housing could be disposed of on this basis).
- Maximising the potential of home ownership and shared equity schemes to reduce public subsidy requirements and to support the creation of more mixed communities – with agreed fallback strategies, if properties cannot be sold due to the prevailing availability of mortgage finance.
- The introduction of financial recycling arrangements that would permit housing associations to apply surplus capital funding and disposals proceeds directly to the funding of new housing, to supplement resources from the Affordable Housing Investment Programme.
- Front funding of programmes by housing associations that have the financial resources to do this.
- Joint working by the Government and the housing and construction sectors, to make the necessary investment in promoting the development and greater use of Modern Methods of Construction in Scotland, to help contain future growth in construction and subsidy costs.

**Glasgow and West of Scotland Forum of Housing Associations  
January 2009**

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## References

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