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Boosting affordable housing supply in England:
Could revenue support work alongside capital grant?

A discussion paper by the Chartered Institute of Housing

Executive summary

Calls to boost the supply of affordable housing, especially to build more homes for letting at social rents, usually ask for additional government financial support beyond the current Affordable Homes Programme. The difficulty is that increasing upfront subsidy puts extra pressure on government borrowing at a time when reducing it is a government priority. Is there a way in which government could provide extra support without adding substantially to the deficit?

The current Affordable Homes Programme (AHP) achieves its output via a combination of capital grant funding and 'nil grant' provision, funded from social landlords' own resources. Under the current programme for 2016-21, the balance is about 70:30 grant : nil grant, with grant being typically about £39,000 for Affordable Rent units and £32,000 for shared ownership units.[1]

One option for financing additional investment could be to introduce a third source of funding: revenue support towards borrowing costs, as a way to provide extra new homes beyond those financed by capital grant. Over the life of a project it would be more expensive than upfront grant, but it could be an effective way to boost output for a period in which the need for more social housing is particularly acute.

If taken up by housing associations, revenue support would have less immediate impact on the public finances than extra capital grant because although the final cost is higher it is spread over a period of years. It has disadvantages too, such as the need for a firm contractual arrangement over the life of the grant and the potential balance-sheet impact on associations.

If taken up by local authorities, there may not be an equivalent saving in public borrowing (unless rules were changed). However, it might be a way to support authorities to develop ambitious new build programmes at a time when their finances have been depleted by rent cuts.

In either case (whether used by housing associations or local authorities), the costs of extra revenue support should at least be partly covered by consequent savings in housing benefit (or the housing element of universal credit). A typical level of revenue support per social rented unit (with no capital grant) would be £4,600 per year. We calculate that savings in housing benefit, assuming tenants would otherwise being paying market rents, could cover half of this annual cost.

Given the constraints on public finance but at the same time the urgent need for greater public investment in housing, CIH is publishing this discussion paper which examines the potential for and drawbacks of using revenue support alongside capital grant. It is not intended as a proposal to make a complete switch from capital grant to revenue support, but to look at the case for using it as a supplementary means of boosting supply in response to the current crisis.

The paper has three parts: it outlines a possible scheme, looks at how it would work for different types of social landlord and compares costs with possible benefit savings.

[1]See the CIH's UK Housing Review 2019, Commentary Chapter 4.

Part 1: How the scheme could work

What is the challenge to be addressed?

CIH's aim – and a high priority for the sector – is the delivery of far more homes in England for letting at social rents. The CIH report Rethinking Social Housing proposes a target of building 90,000 social rent homes per year. This reflects the latest research on housing need by Heriot Watt University.[2] Similar calls have been made by NFA, ARCH, SHOUT, Crisis and others. The Labour Party's green paper also proposed building up to a target of 100,000 new homes per year, 'the majority' for letting at social rents. The government does not have a specific target but has encouraged building for social rent via Homes England's programmes and in its recent removal of borrowing restrictions on local authorities.

Clearly, social rented homes need more grant than the typical £39,000 per unit spent on homes for Affordable Rent. Many commentators have suggested that an average of £70,000 per unit would be required.[3] On this basis, a 90,000 unit annual programme would in theory require a budget of £6.3 billion, although of course a proportion (as now) would be built without grant or via planning gain. If a further significant proportion could be built without capital grant, but by using revenue support instead, this would make it more likely that a 90,000 target could be achieved.

How would revenue support work?

The aim is not to replace capital grant but to create a supplementary new build programme offering sufficient revenue support that it would be the equivalent (for the social landlord) of capital grant, but spread over a long period – say 30 years.

There is a precedent. The Welsh Government has a scheme called Housing Finance Grant which provides such ongoing revenue subsidy to assist HAs with the repayment of private finance, in lieu of grant. It offers a long-term revenue stream as an alternative to capital grant. The Welsh Government aims to boost capital investment by £250 million in total through this means: revenue provision in 2017/18 of £7.7 million increased to £11.4 million in 2018/19 and will grow further to £13.1 million in 2019/20.

The rest of Part 1 of this paper draws on this experience in Wales.

What are typical unit costs?

The Welsh Government's Housing Finance Grant (HFG) has similar costs to those expected for an English scheme. A simplified calculation is as follows:

- capital cost per unit in a typical development might be £120,000
- HFG is set at the equivalent of a social housing grant covering 58% of the capital cost, i.e. £69,600 per unit
- in revenue terms this amounts to approx. £4,600 of HFG annually (since the annual cost is about 1/15 of the cost of the equivalent capital grant), over 30 years.

Of course this is the cost to the WG; the housing association has to finance the full £120,000 via reserves and debt. The debt is then repaid via a combination of rental income and HFG. The total cost to the Welsh Government is approximately twice the value of a straightforward upfront grant, but this is justified in NPV terms.

Is HFG purely an annual subsidy payment?

It is an annual revenue payment to housing associations for 30 years, paying towards the costs of interest and capital payments on borrowings to fund development in an agreed programme. In the Welsh Government Budget, it counts as revenue spending. For housing associations, the principal element of the 30-year funding is treated as being received in year one, with a corresponding debtor, that unwinds through the 30-year period as the annual payments are actually received.

How does the Welsh Government guarantee to the housing association that it will receive the payments?

There is an 'award of funding' which is effectively a contract.[4] The fall-back position, if payments were to cease in future for any reason, is that the housing association could then let the properties at market rents. However in many parts of Wales there is no marked difference between social rents and some market rents so this bail-out may not be that effective in terms of protecting viability in the future.

[2] See the CIH's UK Housing Review Briefing Paper 2018, page 7.
[3] For example, Savills (2017) Investing to Solve the Housing Crisis. London: Savills.
[4] CIH has a blank copy of the award letter, available for those who want to see it: contact john.perry@cih.org

How does the availability of the payment link into raising private finance, and were there any issues in setting this up?

For the first phase of HFG, there was a requirement for housing associations to sign up to a collective finance product. This was to bring a new source of funding to Wales. However, due to the size of the second investment, the Welsh Government required all delivery partners to be included and so removed this criterion. This is because some housing associations have clauses within their lending contracts which do not allow them to borrow elsewhere; this limited the participants in the first phase of HFG to 19 housing associations.

For HFG phase 2, it is up to the housing association to raise the debt. The Welsh Government pays based on the actual interest rate achieved by the association. In year four of the scheme, the Welsh Government will review it to ensure the rates used achieve VFM. This will establish a cap on the funding.

How many Welsh housing associations are involved?

There are 32 signed up so far in phase two. Another two were due to participate in 2018/19. Welsh Government projections for the current financial year show that the majority of the budget has been allocated.

What type of housing is being produced?

Wales has no Affordable Rent provision, so output so far is a mix of social and intermediate rent. One housing association observes that the increased building activity is creating more competition and is pushing up land prices. While they want more output, pushing more money into a system that has not had time to adjust creates pressures that will no doubt be worked through in the longer term.

What are the balance sheet implications?

The additional private finance puts pressure on HAs' balance sheets and loan covenants. For some Welsh housing assoications this has been manageable but some did not want to participate in the first round of HFG for this reason. The Welsh Government had to adopt a blended approach to stop housing associations taking the capital grant and leaving the revenue to others. Its programme is now a mix of HFG and social housing grant. Welsh housing associations have to participate in both programmes. The current intention is that the programme will later revert to being capital grant only.

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Part 2: How might a similar scheme work in England?

What are the balance sheet implications for housing associations?

In Wales the new form of subsidy does stretch balance sheets because Welsh housing associations are generally much smaller. Obviously, an equivalent and potentially larger programme in England, as suggested in Labour's 2018 housing green paper,[5] would have to be robustly tested and trialled for viability. However, given the size of the balance sheets of typical developing housing associations, there should in theory be greater capacity to absorb revenue subsidy. And as in Wales, in effect housing associations' borrowing would be 'credit enhanced' through the receipt of revenue support.

Some of the effects on balance sheets which would have to be considered and managed are:

- While revenue grant provides long-term cash income, an upfront grant does provide a liquidity benefit, particularly for large-scale developing housing associations. The effects on gearing might be greater in more expensive markets and where housing associations have been more significant developers, such as in London.
- Any reduction in capital grant could materially affect loan covenants for English housing associations, particularly where those are based on net debt : social housing grant plus reserves. Using this model, debt goes up but grant comes down, which could impact balance sheet capacity.
- On the other hand, there is a potential 'upside' for interest cover covenants if the revenue grant is scored as income under the covenant.
- There is the issue of how a new arrangement would be structured in loan documentation, i.e. what provisions would have to be incorporated?
- More detail would be needed on how any 'viability' tests on interest costs would be conducted and what is or is not acceptable. For example, if floating rate debt was procured, would the government be prepared to subsidise a fixed percentage of interest costs, i.e. take interest rate or inflation risk? This may impact overall viability.
- Housing associations would have to weigh the risk of changing government policy given that the Welsh model extends over 30 years, i.e. could policy quickly move away from revenue subsidy and if so, what is the fall-back provision and how would it be protected? Loan documents will place strong emphasis on this. Of course, it is a challenge which has been overcome in Wales, and one which the government would have to address to secure confidence in any new scheme.

Are there precedents for wider use of revenue funding?

Yes, although they are limited or from the past. Here are some examples:

- Dowry funding for stock transfers in Wales was an annual revenue payment.
- In England, Decent Homes funding for ALMOs (arm's length management organisations) was at one stage a revenue payment.
- English housing associations have the (older) precedent of revenue deficit grant.
- Another precedent is PFI, which though having bad connotations in other respects shows how long-term revenue funding arrangements can be set up and maintained.
- Finally, English local authoritiess have the (much older) precedent of revenue subsidy for new build until the 1980s.

Could it work for small as well as large housing associations?

As in Wales, in England it would be important to manage the capacity and appetite of larger housing associations alongside the needs of smaller organisations which also want to develop, so that a new scheme did not place them under greater disadvantages.

[5] Labour Party (2018) Housing for the Many.

Could it work with strategic partnerships?

The government is promoting the use of strategic partnership with associations as a way to achieve more consistent and sustainable output of new housing. Revenue support would appear to be ideally suited to such partnerships, as the partnership agreements could embrace a commitment to long-term revenue support alongside shorter-term promises of capital grant.

How would it work for local authorities?

The benefits of this scheme for local authorities are less clear cut than for housing associations, for three reasons.

1. **Public borrowing impact**. One benefit of using an annual revenue payment is that that the housing association or local authority borrows more of the money to fund investment and the government borrows less (assuming that, at the margin, grant is funded by public borrowing). With housing associations this currently means a switch from public to private borrowing; with local authorities, under current conventions, it would not. A transfer from government to local authority borrowing is just a transfer from one kind of public borrowing to another. Things might be different if public sector accounting rules were reformed, but the government is not contemplating this and the opposition has, so far, done no more than suggest the rules are reviewed. Local authorities would, on the other hand, be in a better position to undertake the additional borrowing now that borrowing caps have been lifted.
2. **Nature of the new subsidy arrangement**. HFG has not yet been used by local authorities in Wales which, like England, have had a self-financing settlement (but three years later than England's). Welsh authorities are focused on stock improvement although some have started small new build programmes. In England, local authorities would be anxious that any HFG-style revenue support did not require the reintroduction of Housing Revenue Account (HRA) subsidy, since getting rid of the old subsidy system was one of the main drivers for the April 2012 HRA reforms. Quite simply, a new arrangement that reinstated the old system in any form would be unacceptable. It would need to be based on the costs of the additional borrowing, without having regard (as the old HRA subsidy did) to the state of an individual authority's HRA.
3. **Credibility of government commitments**. An issue for local authorities which applies even more strongly than for housing associations is the credibility of a scheme offering a long-term arrangement, given local authorities' collective experience of the self-financing settlement, where the majority took on substantial extra debt on the basis of stability in the housing finance system, only to see the system radically disrupted by the imposition of cuts in the rental income needed to sustain the new debt.

Both parts of the social sector have been affected by the compulsory reductions in rents which apply over the four years ending in 2019/20, but for various reasons the effect on local authorities' balance sheets has probably been greater. ARCH (the Association of Retained Council Housing) has argued that there should be one-off compensation to LAs whose accounts have been severely depleted by the rent cuts. Without taking a stance on this, the option of revenue support for new build might be more acceptable to government and still provide a way to re-establish the stability of local HRAs. This would require further investigation.

The announcement of a sustainable settlement on rents from April 2020, coupled with the removal of borrowing caps on local authority housing revenue accounts, will clearly boost capacity. When the self-financing settlement took place in 2012, the CIH-National Federation of ALMOs-ARCH report Let's Get Building showed that removing the borrowing caps along with modest access to capital grant could, it was estimated, raise local authority output to 12,000 per year. In the November Budget, the Chancellor projected that local authority output would grow to 10,000 per year.

Another indication of output is provided by the bids that authorities made for the now aborted scheme to selectively raise borrowing caps in high-pressure areas. Bids totalling £2.8 billion in additional borrowing were made by 80 local authorities, aimed at delivering around 20,000 homes over the period 2019/20-2021/22 supported, in part, with around £800 million additional grant.[6] If all the 80 local authorities eligible for the earlier scheme now go ahead with their building programmes, accompanied (at least in part) by possibly lower levels of output from the similar number who were ineligible, output rising to 10,000 or so per year seems perfectly feasible. This could be a significant contribution to the 90,000 new social rent homes required annually.

[6] Data obtained from answers to parliamentary questions 186188 and 188715, November 2018.

However, the unknown factors are how much capital grant will be required and whether it will be available. If the £800 million in grant included in the bids were accompanied by bids for (say) half that amount from local authorities outside high-pressure areas, a resulting total of £1.2 billion would be a significant call on the government's current £9.1 billion commitment to affordable housing over the period to 2020/21.

Revenue support would clearly be a way of adding to the pot of money available to ensure that extra capacity can be taken up. However, given the additional disadvantages that apply if the scheme is used to finance local authority development, one approach would be to limit it to the housing association sector initially, while still making capital grant available to local authorities that need it. The scheme would have renewed relevance to local authorities if in the future the borrowing rules that apply to them were to be reformed.

How would revenue support work in London?

There are particular issues about London because the Greater London Authority (GLA) has devolved responsibility for the Affordable Homes Programme in the capital and this has enabled them to drive their own policy agendas such as strategic partnerships with housing associations and a return to development for letting at near-social rents. It is important that any change in the grant regime does not disrupt such arrangements in London, so it would need careful negotiation with the GLA and providers.

What are the implications for public expenditure?

Both capital grant and revenue subsidy are of course public expenditure, regardless of the status of housing associations or local authorities. Capital grant adds to public sector net debt while both add to the annual deficit (public sector net borrowing). As was noted above, the advantage of converting capital grant to a revenue payment, as effectively happens in Wales with HFG, is that the costs to government are restricted to the annual payment and it is the housing association (or local authority) which takes on the debt. For a housing association in England and now also Wales, the additional debt is in the private sector. This enables the impact on the public finances to be spread, mitigating the up-front impact of an enhanced investment programme.

Are there other potential economic and financial advantages?

Another advantage of revenue subsidy is that it enables a more direct comparison with any cost savings achieved by building homes to let at social rents to households who would otherwise occupy market rented property and receive housing benefit. This is explored in more detail below.

There are other benefit-related advantages to programmes that result in lower rents. For example it is far easier for tenants to secure work that is sufficiently well paid to take them out of benefits. If tenants do not need to rely on housing benefit they can more easily manage to pay their rents if they are on variable incomes. The subsidy to tenants via housing benefit also lasts – in many cases – until death as few social tenants are likely to have pensions high enough to cover Affordable Rents.

Is there an issue about the degree of confidence the sector and the market will have about future subsidy payments?

A point made above about the government not adhering to the terms of the local authority self-financing settlement is part of a wider issue about whether the sector 'trusts' the government as a long-term investment partner. There may well be uncertainty about whether the Welsh Government's 'award of funding' model effectively addresses this if the objective is to generate substantial programmes. Of course, the more certainty that can be built into the process the lower the impact on pricing and vice versa.

A connected point is that if the government is making a 30-year commitment to revenue funding, will it seek a greater degree of 'control' over these properties? Currently housing association have a high degree of flexibility to manage homes / assets subject only to the recycling of any grant.

These are issues which the government would have to address, in partnership with the sector, if the revenue support model were to go ahead.

Part 3: How does a HFG funded programme compare with cost savings in housing benefit?

What is the case in outline?

A private tenant claiming housing benefit is typically claiming almost £32 per week more than a tenant paying social rent.[7] For this reason, various attempts have been made over the last few years to show what cost savings can be achieved from a bigger new build programme with units let at social rents. The studies allow the conclusion that an expanded social housing new build programme could (if conditions were right) be partly financed by savings in the housing benefit budget. If the subsidy required for new build were in revenue form, it would at least be partially matched by direct housing benefit savings. This would avoid the need to express future savings in NPV terms and the £-for-£ savings would, therefore, offer a more convincing case for the additional investment.

What evidence is there about how costs compare with expected HB savings?

Comparisons of the costs of an enhanced social rental programme with potential savings in housing benefit have normally been based on higher capital grants (rather than new revenue subsidy). For example, the Lyons Review suggested that the cost of higher grant would be paid back by housing benefit savings after 12 years. A report by SHOUT and the NFA said that the equivalent of about 60% of the capital grant would be covered by HB savings in NPV terms.[8]

A straight comparison of typical housing benefit costs per head, where the difference between tenants in the private sector and local authority tenants is almost £32 per week (see above), suggests an annual saving in the region of £1,600 per unit, which might be regarded as a minimum. In practice, new households needing a home and unable to access social housing are likely to have to pay higher rents and require higher housing benefit payments than the average.

Savills have calculated that the savings in housing benefit would be much greater, at about £4,300 annually.[9] They estimate that a tenant would typically receive £8,490 in housing benefit if paying market rents, but would only need £4,180 if paying social rents. The Savills calculation is based on all new tenants otherwise paying market rents, and receiving housing benefit up to the levels permitted by Local Housing Allowance (LHA) limits based on the two-bed rate. Perhaps not surprisingly, almost three quarters of the total savings thus achieved from a national programme are in London.

On this basis an enhanced social rent programme would almost pay for itself in terms of housing benefit savings. Savills' calculation can be criticised, however; for example it is quite a leap to assume that all new tenants occupying the extra social rented stock would otherwise have been paying market rents at full housing benefit levels. In practice, the savings are likely to be lower for various reasons, e.g. restrictions on benefits which tenants would receive (not only LHA limits, but via the benefit cap, etc.), the fact that new tenants may be from concealed households which otherwise would not have formed, and differences between the characteristics of the general population and those entitled to housing benefit. For example, the majority of private tenants entitled to HB are entitled either to the shared accommodation or to the one-bed rates (and the proportion is even higher among those on a passport benefit entitled maximum housing benefit).

A new calculation of potential housing benefit savings

For this paper CIH carried out a new assessment, assuming 10,000 new social rent units are built using revenue support and tenants housed in them would otherwise be in the private sector and receiving housing benefit. The calculations are shown in the Annex, and they include weighting of the programme in a similar way to the current AHP, i.e. that funding is heavily directed towards the southern regions of England (a differently weighted programme would produce different savings).

[7] See UK Housing Review 2019, table 114a; the comparison is between LA and private tenants as HA tenants will include those paying Affordable Rents (only a very small proportion of LA tenants do so).
[8] Capital Economics (2015) Evaluating the economic case for building 100,000 new social rent homes each year. London: SHOUT-NFA. CE estimated that of a £57,000 per unit capital grant, some £37,000 would be covered by HB cost savings.
[9] See www.savills.co.uk/research_articles/229130/246736-0

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On the basis of the costs set out in part 2 of this paper, a 10,000 unit programme would cost £46 million annually in revenue support. Our estimates of the housing benefit savings suggest that about half the cost of the programme could be offset by reductions in the housing benefit budget. We calculate that the programme could save £26 million annually if comparison is based on the lowest social rents in each area, and £23 million if comparison is based on the highest social rents.

Savills' work and earlier studies also indicated that, at the very least, the extra cost of subsidising social rented new build would be significantly offset by housing benefit savings. Our estimates are not as optimistic as these, nevertheless they confirm that the savings are potentially substantial and add to the case for considering a new, revenue-funded building programme in England to supplement the current Affordable Homes Programme.

Annex: Calculation of housing benefit savings from an enhanced social rent programme

Current data on social rents from CORE and MHCLG are compared with housing benefit awards to private tenants. Data are available by property size and local authority area to take account of variations in rents. The housing benefit data are based on the award (rather than the rent level) made to private tenants.[10] After identifying the average rents in each area for the one-bed to four-bed LHA categories, the average private rent was calculated by weighting each category according to the caseload.

The weekly housing benefit savings were calculated by comparing the average private rent with the average social rent for each local authority area, aggregating these into regions by applying a weighting based on the housing benefit caseload. Finally the weekly regional savings per case were used to calculate the total savings for each Homes England/GLA operating area, by weighting them according to distribution of the now completed AHP 2015-18. The difference between the higher and lower estimates arise from the (usually) lower rents that apply to local authority-owned units in areas where councils have retained stock, in which case the lower of the council or housing association rent is used.

The tables below show the annual savings from a hypothetical 10,000 unit programme. Table A gives results where the higher of either the average for local authority or housing association rent in each local authority area is used, and table B for the lower of the two averages.

Table A – Highest average social rent (usually HA rent)

Region	Weekly saving per unit	Annual saving per unit	Build programme (units)	% of build programme	Total annual saving	Saving as % of total
North West	£16.66	£866	400	4%	£346,551	1.52%
North East	£10.27	£534	500	5%	£267,058	1.17%
Midlands	£12.26	£637	1400	14%	£892,352	3.92%
South East	£33.46	£1,740	2500	25%	£4,349,723	19.12%
London	£93.92	£4,884	2800	28%	£13,674,724	60.10%
South West	£25.82	£1,343	2400	24%	£3,222,274	14.16%
Average/ Total	**£28.83**	**£1,499**	**10,000**	**100%**	**£22,752,682**	**100.00%**

Table B – Lowest average social rent (usually LA rent if stock retained)

Region	Weekly saving per unit	Annual saving per unit	Build programme (units)	% of build programme	Total annual saving	Saving as % of total
North West	£19.35	£1,006	400	4%	£402,535	1.77%
North East	£14.08	£732	500	5%	£365,965	1.61%
Midlands	£18.56	£965	1400	14%	£1,350,819	5.94%
South East	£38.83	£2,019	2500	25%	£5,048,231	22.19%
London	£107.54	£5,592	2800	28%	£15,657,769	68.82%
South West	£31.34	£1,630	2400	24%	£3,910,849	17.19%
Average/ Total	**£34.63**	**£1,801**	**10,000**	**100%**	**£26,736,170**	**100.00%**

[10] To identify the rent (or the maximum rent paid by HB if lower), only local housing allowance awards (sorted by property size) for tenants on a working-age passport benefit were taken, after screening out households with non-dependants and awards that were exceptionally high or low.

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