

**The Scottish Government's agenda for funding  
new affordable housing: The Affordable  
Housing Investment Reform Project**

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Anna Evans

## The Scottish Government's agenda for funding new affordable housing: The Affordable Housing Investment Reform Project

This briefing summarises the presentations at HQN's recent event which explored the Scottish Government's agenda for affordable housing, considering the Affordable Housing Investment Reform Project in particular, but also the economic context and how this is likely to affect development in the short term.

### The Scottish Government's agenda for funding affordable housing development

*Bill Baron, Head of Housing Investment Reform Project*

Bill Baron is responsible for taking forward the Investment Reform Project, and while he was asked to speak about this, he emphasised that the agenda is currently much wider: it involves adapting the current system to make it more efficient; coping with the economic context; debating the size of the budget with the Treasury; projecting how the banking sector and therefore lending for development may work out; and, considering what role council house building may have in the future. What is clear is that the supply of affordable housing is even more critical now than it was 18 months ago when *Firm Foundations* was published.

The consultation period for *Investing in Affordable Housing: A Consultation* is now concluded and the Scottish Government (SG) has received 150 responses which will be trawled through and analysed over the coming months.

The key objectives of the reform are to make the affordable housing investment system:

- Strategic – deciding in advance what need to be built and where. The Strategic Housing Investment Plans (SHIPS) are not yet perfect, but the SG believes they are moving in the right direction
- Competitive – key – making the money go further. The numbers of affordable homes delivered matter, but not at the cost of quality
- Strategic and competitive – the trick is to achieve both of these aims, but the SG is clear that strategic comes first.

In terms of the key proposals for reform:

- Lead developers, local housing associations and development consortia – it is clear from the responses to this aspect that housing associations, lenders and lawyers see complexity which perhaps was not originally envisaged and the SG sees that the debate on how this aspect will be organised still has some way to run
- Prospectuses and regions – SHIPs are generally accepted as a useful tool, and the concept of regions was put forward so that housing associations would not be compelled to work in constrained areas. This is an area which has been

misunderstood in the consultation and which requires re-visiting. It was suggested in the presentation that there may in fact be no need for any boundaries at all, with housing association groupings being free to shape their own development geography

- Pre-qualification, competition and appointment of lead developers – the SG has copied the process from well-established procurement good practice to help obtain quality and best price. The whole purpose is to select lead developers to whom the SG is willing to commit funding for a long time and therefore help build in efficiencies to the procurement process due in part to more funding certainty.

The intention is to provide a flexible framework with:

- Not too many boundaries – there are big question marks over the regional boundaries and whether to have them at all
- Multiple lead developers – wish to see more than one in any particular area
- Mixed economy – there may be a mix of lead developers and some stand-alone housing associations
- More radical options – there were questions raised in the consultation process as to why lead developers had to be housing associations – why not different models, including non-housing associations and developers?

What happens next? Analysis of responses will take place over the next few months. However, it was emphasised that the world has changed since the process commenced and there is no certainty over what the outcomes may be, and even less over timescales for implementation. Bill also emphasised that the consultation responses have yet to be analysed and the results will influence the next steps.

Comments and questions put to Bill considered:

- Regional boundaries – endorsing the belief there is a strong case for no boundaries and leaving housing associations to form their own groupings and geography
- Transitional arrangements – with the shift in the market, what arrangements were being put in place to manage the change? The response confirms that it would be surprising if timescales set out in the consultation document were met
- Local authority procurement – why were local authorities not doing all the housing procurement (whether council housing or housing associations) as they do for social care, education, etc? The response was a valid argument for some, but not one the government has chosen for housing procurement.

## The credit crunch and regeneration

*Colin Armstrong, HQN Associate*

Colin Armstrong is a housing regeneration consultant. Based on evidence from English-based research<sup>1</sup> he discussed:

- How the credit crunch is affecting regeneration
- Implications for the housing sector
- What the policy response should be.

In a nutshell, the present property market situation was summarised as: lenders won't lend, buyers won't buy, sellers won't sell, and builders won't build. The market is now increasingly limited through uncertainty and lack of consumer confidence. All sectors are affected, although housing markets have been hit first, and worst so far. The financially marginal are being affected most including:

- Places – the poor quality and shaky markets including regeneration areas
- People – those on low income and with high loan-to-value ratios
- Projects – short term and those with low profit margins
- Partners – those which have relied on debt or who have poor track records.

The risk to regeneration is that ultimately it will falter for the short to medium term. This is due to loss of momentum and confidence to invest. The downsizing in the construction industry means that there will be a loss of the skills base, which will take some years to rebuild. This may also affect the public sector, specifically in local authorities where important regeneration co-ordination and planning skills are located: lack of housing and infrastructure activity will mean loss of income for local authorities which may result in cost control exercises and possible staff redundancies.

There are also risks for mixed tenure. The recent SG acceleration funding has led to some developers selling unsold stock to housing associations – will this bring a return to mono-tenure estates? In addition, affordable homes that may have been delivered through 'planning gain' will not be achieved, and housing associations are also feeling the squeeze through lower grant, lower valuation and the impact on loan-to-value ratios (LTVs), and reduced availability or higher cost of funding.

What should we do? It should be recognised that regeneration is for the long term and emphasis should be placed on place-making, and good long-term master plans. In order to keep momentum going, partners should consider developing rented housing upfront and

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<sup>1</sup> There has been little Scottish-based research to date, although Colin suggested that this is a gap which the SG and other organisations may wish to consider.

bring forward mixed uses to give cashflow for developers and when the market recovers the private housing can follow. But many projects require upfront infrastructure investment before any housing or mixed-use development can commence, much of which cannot be afforded by developers in this market. The recommendations of the Housing Supply Task Force to explore new funding models for infrastructure are therefore welcomed.

On funding, it was argued that the SG programme from 2010 is inadequate and that the Housing Supply Taskforce recommendations on public sector land were disappointing. It was recommended that the public sector should become a long-term investor and therefore:

- Reduce the finance needed from the private sector
- Share the risks and rewards
- Recycle profits
- Use intermediary vehicles, eg, Urban Regeneration Companies, EDI.

In terms of the buying and renting balance, it is unlikely that we will ever see a return to 100% or 100%+ mortgages. The result will be that young people will have longer waiting and saving times. This may increase the need for rented housing (whether private sector and social housing) and shared equity.

Finally in terms of the skills base, policy makers should be careful to preserve and or track the skills that may currently be leaving the private and public construction-related sectors so that when the upturn in the economy comes, all sectors are able to respond quickly to mobilise resources.

## **The credit crunch, development funding prospects and national implications**

*Jonathan Fair, Chief Executive, Homes for Scotland*

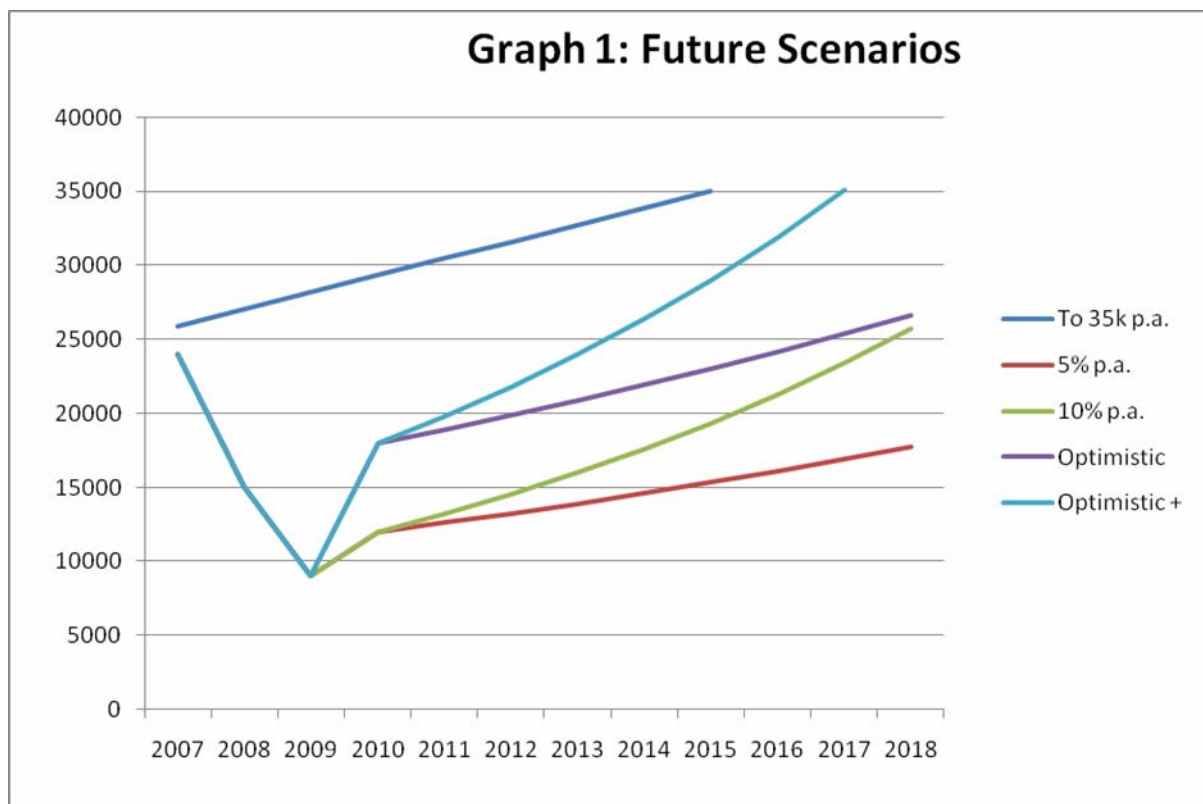
One of the key drivers in the change in the housing market is the availability of mortgages: Jonathan's presentation started with an illustration of the number and type of mortgage products that are available today across the UK compared to 18 months ago. In the summer of 2007 there were approximately 16,500 mortgage products on the market: now there are only 1,500. The type of products has also changed, away from first-time buyers and 100%, towards higher deposits:

- First-time Buyers, 100% products – only three today
- 10% deposit – 60 approx
- 25% deposit or less – 380 approx
- 25% deposit – 500 approx

- 40% deposit – 350 approx.

Through a discussion of various building rate scenarios it was demonstrated that to achieve the SG target for 35,000 houses per annum from the current very low build rate (approx 9,000 per year), the rate would have to increase to something similar or beyond the post-war build programme in the 1940/50s, or the 1970s replacement programmes (see graph below).

It was stated that the credit crunch is having a serious impact on Scotland's construction industry, with 26,000 jobs already lost in 2008, and up to 100,000 at risk. It will be unable to meet the SG's target for 35,000 houses per annum and this will have knock-on effects to the need for affordable housing, but also wider social and economic impacts as related investment in infrastructure, schools and community facilities does not occur.



Data on new build starts, registrations and completions were provided, demonstrating the rapid decline in the housing market over the last year:

### Scottish private new build starts/registrations: 9,800 units

**2007 2008**

Q1	4135	4004	= down 3%
Q2	5590	3043	= down 45%
Q3	6092	1654	= down 73%
Q4	5106	1051	= down 79%

## Scottish private new build completions: 14,900 units

### 2007 2008

Q1	3948	3692	= down 7%
Q2	5280	4550	= down 14%
Q3	3816	3222	= down 16%
Q4	5571	2766	= down 51%

Land valuations are also down. Evidence from Homes for Scotland members suggest these are down at least 25% on 2007 prices, and 80% in the case of distressed assets. This will have an impact on public sector vendors, who may have planned on land sales to make significant contributions to income.

What are the impacts on policy objectives likely to be? Jonathan argued that the downturn in house building will have ramifications across social policy objectives, and particularly in relation to housing need, demand and increasing homelessness; lack of delivery of affordable housing via section 75 agreements; impact on economic growth, loss of jobs and source of training programmes in the construction sector for the short term.

Practical actions were discussed, focusing on reducing risks in a period when protection of cash and cashflow is critical for survival for many house-builders and developers. In particular, infrastructure costs and finding different funding models were discussed, as was the role of affordable housing investment as a means of kick-starting development including:

- Phasing – front-loading developments with affordable housing
- Buying land/stock – with accelerated and other funds
- Design/build deals
- Adjusting tenure mix – with flexibility for when the market returns.

Finally, the developers' ability to evolve and adjust to market conditions was emphasised. Examples of common practices include:

- New mortgage models (shared, underwritten or longer)
- Valuations with buy-back guarantees
- Greater variety in house types and bespoke ordering (with days of ordering off-plan gone for the short term)
- Partnership working with housing associations
- Private rental investment vehicles.

The presentation was concluded positively with a call to be ready for when housing demand comes back. In the meantime it was argued that more innovation and funding is required to support the industry and meet housing and economic policy objectives.

## **Local authority building: back to the future, or Concordat dreams?**

*Alan McKeown, Head of Housing, Angus Council*

In his opening remarks Alan suggested that a game of political cat and mouse is being played in the current housing funding debate, and in considering local authority house building he wished to consider:

- Why we are here?
- What are the rules?
- Who is playing?
- The perceived negatives...
- ...and the positives of council house building
- What will happen next?

The context was set arguing that there has been marginal financing of housing over the last ten years, coupled with the negative impact of the Right to Buy, and while aspirations and standards have increased, there has been little consideration of the actual financing/resourcing of the implications of the 2001 and 2003 Housing and Homelessness Acts. The reality is that regardless of the finally agreed mechanism for delivering investment reform, there has to be greater supply in affordable housing and there is currently an opportunity for local authorities to deliver some of this supply.

The six 'rules' set out by the SG for local authority house-building are:

- Rule one – ability to manage and maintain
- Rule two – prudential borrowing capacity/£
- Rule three – subsidy <£25K per unit
- Rule four – have housing need and contributes 2012 target
- Rule five – can demonstrate delivery plans
- Rule six – maximum site density, but not at the expense of design quality
- Extras – need land, political support and capacity.

There are 18 councils that have bid for resources to build. The total units proposed are 3,345, equivalent to a total bid of £84m against the total available SG funds of £25m, equating to a subsidy level of £25,000 per unit. This compares to a typical housing association subsidy of £65,000 per unit and total subsidy of £217m for the same number of units. However, it was stressed that it is not a level playing field due to the local authorities' advantages in borrowing rates and for some access to land.

The perceived negatives in the initiative are:

- The removal of potential housing association sites from their strategic development plans
- A creation of tension between the housing associations and the local authority strategic role
- Pursuance of a short-term gain (whether supply and political gain) against a longer-term land bank
- Risks of putting density first before quality and sustainability
- Increasing rents to levels that may exclude low paid employed tenants
- Has not encouraged many innovative financing models.

From the local authorities' perspective there are number of positives. These are broadly around political and PR gain, but more importantly around delivering supply and, according to the numbers, providing value for money which is not currently achievable in the housing association sector. The positives are summarised as:

- National and local political win
- Value for government cash
- Meets housing and economic policy objectives (2012 target and jobs)
- Prudential borrowing is available and secure
- New build is not liable to Right to Buy
- Demonstrates a different way to deliver which challenges conventions.

Alan concluded by emphasising that the local authorities' next challenge will be actually procuring and delivering on the ground. He sees the initiative as presenting opportunities for further development of financing models and demonstrating different ways of delivering to challenge conventional HAG wisdoms. During question time it was noted by housing association contributors that, at £25,000 subsidy, the housing association sector could never compete with the local authorities. However, Alan noted that this 'initiative' should not be seen as a long-term threat to housing associations due to the finite level of

borrowing that local authorities can bear in the prudential borrowing framework, but that it does provide an opportunity to contribute to some of the supply requirement, and think differently about funding options.

## **Housing association development: proposed changes to the development funding process?**

*Maureen Watson, Policy and Strategy Director, Scottish Federation of Housing Associations*

Maureen presented a summary of the SFHA's response to *Investing in Affordable Housing: A Consultation*. The overall theme of the response is that the consultation is fundamentally flawed. Maureen drew on evidence from the English experience of larger developers where, she stated, the model has now failed in a way which has not occurred in Scotland. In summary, the SFHA challenges the general assumption in the consultation paper that small is bad and argues that small is good for very good reasons – it works well in rural settings, which is so important in Scotland, in infill sites, and for mixed-tenure schemes. Apart from the various specific reasons for objections to the consultation proposals, the SFHA believes the timing is wrong and timescales are out, given the economic and financial context.

The specific SFHA objections to the consultation proposal are in relation to the lead developer concept, the regions and the proposed method for consortia.

In relation to competition, the SFHA:

- Is against competition for grant
- Believes competition will create abortive bids
- Therefore feels it will add costs for housing associations, rather than efficiencies, and will not speed up the procurement process
- Does not believe it fits with the strategic focus in the consultation proposals.

In terms of the regional prospectuses it is the SFHA's view that the proposed regions are one of the most flawed aspects of the proposal, and one with which it strongly disagrees. The SFHA:

- Cannot see the logic behind the regions that are proposed, other than that it is an attempt to create areas that can deliver bulk procurement in sufficient scale
- Does not understand why the regions are not related to existing housing market areas, or to the areas of operation of housing associations and contractors
- Believes that it is wrong to exclude Glasgow and Edinburgh, which account for around a quarter of the annual budget, from the mainstream of the proposals

- Believes regions will limit the natural development of consortia.

Further, in relation to the proposed method for consortia, the SFHA argues that:

- It cannot see the advantages and benefits that would accrue to a lead developer, in exchange for the significant level of risk that goes with the role
- Development delays would be inevitable as the lead developer framework is being established and consortia set up
- It is unclear how consortium members would have appropriate input into the procurement process
- Lenders are anxious about the level of risk and complexity involved in the proposals and would prefer to spread risk across housing associations
- It would significantly reduce voluntary control of community regeneration
- It would impact on small local businesses if consortia only work with a few preferred partners
- It would create transaction costs associated with implementing consortia for associations and liaison with the government.

The SFHA believes that, if consortia arrangements are to work, they need to develop organically. The SFHA urges the government to look at existing partnerships and consortia to learn from their experience and knowledge, and to consider working with these consortia and allowing them to continue and develop their arrangements. It also believes that where other associations wish to develop new consortia, then they should be encouraged to do so, but it is essential that any consortia arrangements relate to natural areas of operation (of both housing associations and contractors), rather than the artificial regional boundaries proposed.

In terms of regional prospectuses, the SFHA believes it is right to take a strategic approach, but for reasons outlined above is not convinced the regions proposed should be used, but rather that the current SHIPs should be used until such time as more suitable regions are defined (if at all) in line with housing market areas.

The SFHA does support a number of themes from the consultation document. It welcomes:

- A strategic approach
- Any improvement to the current system that will help meet housing need
- Long-term funding arrangements.

However, it believes there are a number of issues missing in the document, specifically:

- Land supply – research suggests that the biggest driver to house cost inflation is land price inflation, but the consultation has not addressed the issue of land ownership which limits the supply of housing
- Infrastructure – the funding of infrastructure is a major barrier to increasing the supply of housing in Scotland. Prior to the current recession, this was already creating long delays on large, strategically important sites. The SFHA believes that a new system has to be developed to ensure infrastructure is funded upfront, and is pleased this issue has been highlighted by the Housing Supply Task Force.

Maureen concluded her presentation by reaffirming that the SFHA wants to see increased supply of affordable housing and value for money, whilst improving quality. However, it cannot support the consultation document as it believes it will not achieve these aims. The SG should instead be taking full account of the strengths of the current system in Scotland and building on these to increase supply.

## Helping first-time buyers and current home owners

*Yvonne Gallacher, Chief Executive, Money Advice Scotland*

Yvonne Gallacher's speech covered an introduction to Money Advice Scotland (MAS) – what it is and what its members do; issues for current home owners; issues for first-time buyers, and possible solutions.

The credit crunch – what does it mean for consumers? On the positive side, interest rates are at an all-time low, but on the downside lending has contracted significantly for some client groups, particularly the more 'risky' young households, lower incomes, or high loan-to-value ratios. The government is subsidising banks to improve lending to individuals to businesses, but in terms of the pre-action protocols for defaults this is not required in Scotland as it is in England and Wales.

How can money advisers help? MAS advisers are trained to take a holistic approach to circumstances where client approach for debt problems. They aim to maximise income and reduce expenditure, would write to creditors and negotiate on clients' behalf and offer options. The presentation included an example of a couple experiencing mortgage arrears, and unsecured 'problem debt' and the clients were 'burying their heads in the sand'. A number of options were explored that may well be considered in a real life situation:

- Voluntary pro rata debt management plan – this is where the debtor enters into a voluntary arrangement to offer to pay X over a period of time
- Trust deed – this is a voluntary agreement with creditors and not binding unless creditors agree to it, and all assets vest with a Trustee who is an Insolvency Practitioner
- Protected trust deed – this is a special kind of trust deed that is binding on the creditors

- Statutory Debt Arrangement Scheme – if this is approved then creditors cannot pursue further for debt. A home is protected from diligence so long as the debtor keeps up payment with the mortgage
- Token payments/moratorium – depending on some circumstances some creditors will allow token payments to be made until the debtor can sort out their situation
- Mortgage to rent scheme – as long as the householders don't have more than £2,000 capital and are under 60, this may be an option if mortgage or shared equity is unaffordable, but they wish to still remain in their own home
- Mortgage to shared equity – owners would remain in their home but reduce levels of debt secured against it
- UK homeowners' support scheme – details of which are still to be announced (at the time of the presentation).

In terms of first-time buyers, money advisers will help plan income and expenditure ahead and check affordability. They will also explore the LIFT options including the new supply shared equity scheme and the open market shared equity scheme. The solutions which MAS members employ are as follows:

- Financial capability and money guidance
- Capacity building and confidence
- Encourage saving (and future borrowing –affordable credit) through credit unions and CDFI, etc
- Access to free advice and information services which can offer the various options with confidence
- Access to payment methods which relate to users circumstances
- Adequate funding of the above.

The presentation was concluded by reiterating that there are difficult market conditions for owners and first-time buyers. In Ms Gallacher's opinion some of the problems her members face would be alleviated with a greater supply of affordable housing and affordable credit to sit alongside affordable rented housing. One of MAS's aims is to work together with others involved in the housing market to make home ownership more sustainable and viable, particularly in the current economic climate.

## Development prospects

*Anna Evans, HQN Associate*

One of Anna's specialisms is to advise investors and developers on the Scottish housing policy and financial system. Her current work relevant to this event is the SG evaluation of Devanha jointly with Heriot-Watt University (the bulk procurement initiative in the North East of Scotland); and she is also advising LxB, the investor at Winchburgh in West Lothian – a long-term growth area where 3,450 houses will be delivered, 25% of which must be affordable.

Anna concluded the event by summarising issues raised in the various presentations, providing recent data on key influences and indicators in the housing market, and reaching some conclusions on short-term development prospects and possible policy responses:

- Since the credit crunch and the onset of recession, demand has plummeted, in the main caused by a 40%-50% reduction in mortgage finance (Scotland and the UK respectively), and a 90% reduction in the number of mortgage products available (across the UK)
- In terms of economic drivers, 15 years of uninterrupted growth is over, with unemployment at a ten-year high, and redundancies that started in the house building sector now progressive across sectors
- Repossessions were up 54% in 2008, and are projected to increase to 75,000 in 2009 across the UK
- On prices, Scotland is holding up well compared to the rest of the UK. In January 2009 the average price decrease of 6.3% in Scotland was nearly half that of the UK figure of 11.5%. However many forecasters, including Roger Bootle, the former Chief Economist at HSBC, project much greater falls before the end of the recession – as much as 40% in residential values and 70% in residential land values
- The supply response has been the almost cessation of new build in Scotland – from approximately 24,000 completions per annum, or 2,000 per month, to 350 completions in January 2009, 150 of which were in the private sector
- Development constraints add to the problem – the planning system, and infrastructure funding requirements on developers and investors. These have been highlighted as priorities for the reconvened Housing Supply Task Force
- Completions in the Scottish housing association sector are down by 40%, caused probably by the change in HAG assumptions, but possibly also the lack of Section 75 affordable homes delivered through the private sector

- Council house building may help plug some of the gap in the short term, but only making a relatively small contribution in national terms, and only in those areas where the local authority can afford to build
- Mid-market rent will also be an opportunity to meet unmet demand at lower grant levels than is required for social rented supply.

Anna concluded that further Scottish and UK intervention is required to help the failing housing market, but the already high levels of UK debt and the extent of further calls on the public purse will mean there is insufficient public finance to solve the problem. As well as any additional financial subsidy, there should therefore be support to find innovative models to fund affordable housing in the future. English colleagues have already started this debate, and Scottish policy and market leaders should quickly engage and learn from this discussion.

HQN is the largest independent housing training and consultancy company in the UK. Over 680 housing organisations nationwide subscribe to The Housing Quality Network which provides high quality briefings and workshops on a wide range of issues affecting the sector. We also run a number of specialist networks, provide bespoke consultancy and research, in-house training, interim management (The Pool) and executive recruitment (The Source) services and host a comprehensive programme of conferences and seminars.

**For further information, please contact:**

Consultancy: Jason Lukehurst – [jason@hqnetwork.co.uk](mailto:jason@hqnetwork.co.uk)

The Housing Quality Network: Claire Turner – [claire@hqnetwork.co.uk](mailto:claire@hqnetwork.co.uk)

Specialist networks: Ben Osborne – [ben@hqnetwork.co.uk](mailto:ben@hqnetwork.co.uk)

Events: Fiona Macfarlane – [fiona@hqnetwork.co.uk](mailto:fiona@hqnetwork.co.uk)

Training: David Ganz – [dave@hqnetwork.co.uk](mailto:dave@hqnetwork.co.uk)

The Pool: Ruth Leap – [ruth@hqnetwork.co.uk](mailto:ruth@hqnetwork.co.uk)

The Source: David Ganz – [dave@hqnetwork.co.uk](mailto:dave@hqnetwork.co.uk)

**Or call any of the above on 0845 4747 004 For further information: [www.hqnetwork.co.uk](http://www.hqnetwork.co.uk)**