

Client

Department of Families, Housing, Community  
Services and Indigenous Affairs

Project

# UK Housing Indicators

Date

8 Jun 2010

Contact

Dr Tony Gilmour

9387 2600

[tony@elton.com.au](mailto:tony@elton.com.au)



**Sydney**  
t (02) 9387 2600

PO Box 1488  
Level 6, 332-342 Oxford St  
Bondi Junction NSW 1355  
f (02) 9387 2557  
consulting@elton.com.au  
www.elton.com.au  
ABN 56 003 853 101

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Prepared by	Dr Tony Gilmour
Reviewed by	
Date	8 Jun 2010
Job number	10/1836
Document name	UK housing indicators
Version	2

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## Acronyms

AHURI	Australian Housing and Urban Research Institute
ALMO	Arms length management organisation
CLG	Department for Communities and Local Government
DWP	Department for Work and Pensions
CRA	Commonwealth Rent Assistance
GFC	Global financial crisis
HCA	Homes and Communities Agency
RBS	Royal Bank of Scotland
RPI	Retail Price Index
RSL	Registered Social Landlord – another term for housing association
RSR	Regulatory and Statistical Returns
THFC	The Housing Finance Corporation
TSA	Tenant Services Authority

# Executive Summary

During two decades of radical reform, the UK has moved from a public housing sector that appeared in terminal decline to a buoyant social housing sector dominated by non-profit housing associations. These associations are popular with tenants, governments and financiers alike. In Britain's major cities, monolithic local authority control of portfolios of upwards of 50,000 properties has been broken down among smaller, more locally responsive organisations. Little wonder than policy makers in Australia look to the UK as a model to follow.

There are, however, many pitfalls in copying policies between countries with different characteristics. The UK, unlike Australia, has a relatively large social housing sector, a tradition of high capacity non-profit providers, strong national regulation and a sophisticated finance sector. While UK institutions are enthusiastic investors in housing association loans and bonds, Australian investor appetite is uncertain, markets less liquid, and sector knowledge less developed (Gilmour & Milligan, 2009).

Furthermore, the generous support for tenant incomes through Housing Benefit, paid direct to UK housing associations, is not matched in scale by Australia's Commonwealth Rent Assistance. Demand-side support of tenant income has underpinned UK private finance investment in social housing. Strong cashflows rather than asset backing are the reason why British housing associations have been able to borrow significant sums from banks.

Despite these national differences, experience from the UK highlights several benefits brought by stock transfer and the introduction of private finance. In particular these policies have helped drive the professionalisation of the entire sector - of housing associations, regulators and government agencies. Institutional investors and lenders now have a greater stake in the sector's success, helping build a broad coalition favour in support of affordable housing.

Private finance has allowed English housing associations to establish a greater critical distance from government, despite a strong national regulatory system for the sector. With

loans not tied to particular property schemes, associations have freedom to innovate. Many larger housing associations have pioneered new and potentially better social housing solutions, environmental design initiatives and approaches to tenant engagement. It is unlikely that these would have been possible in the public sector.

There is evidence that UK associations are now taking the lead in neighbourhood regeneration, promoting social inclusion and encouraging higher levels of employment. The policy of open disclosure of information by associations, and the use of performance indicators, is helping drive down costs. Benchmarking has been used to identify less efficient housing providers.

The down-side with private finance, evident during the GFC, is that reducing grant finance too low can encourage housing associations to take greater commercial risk. This includes undertaking market-rate projects to cross-subsidise affordable rental housing. Many of these schemes are not sustainable during an economic downturn, particularly when property prices fall sharply (Inside Housing, 2008).

'Private finance is a fair weather friend. When the economy is strong, it still requires underpinning through support of tenant income, capital grants and tax breaks. When the economy collapses, governments must step-in to prevent the failure of housing providers leading to the eviction of low-income tenants' (Gilmour, 2010: p.6).

UK government support, provided in 2008 and 2009 to several struggling housing associations, prevented systemic failure. Commercial loans to social housing organisations appear to operate best in conjunction with, but cannot substitute for, public investment and support. In spite of major dislocations in property and finance markets during the GFC, the UK's approach to reforming social housing through introducing private finance has proven resilient.

## Acknowledgements

Part of the background material for this report was collected through a desk-research project sponsored by the WA Government, and published by AHURI (Lawson et al., 2010). Further information was assembled for a subsequent unpublished paper based on stakeholder interviews (Gilmour et al., 2010).

# 1 UK Background

Since the introduction of private finance in 1988, mainly in the form of bank loans to non-profit 'housing associations', the funding model of the UK's social housing sector has been transformed. This has allowed governments to progressively reduce the level of grant support to the housing association sector such that it is now just below the level of private finance.

During the last two decades associations have increased their professionalisation, innovated with new housing and community development approaches, increased housing supply through own resources and developed a relationship more at arms' length from government.

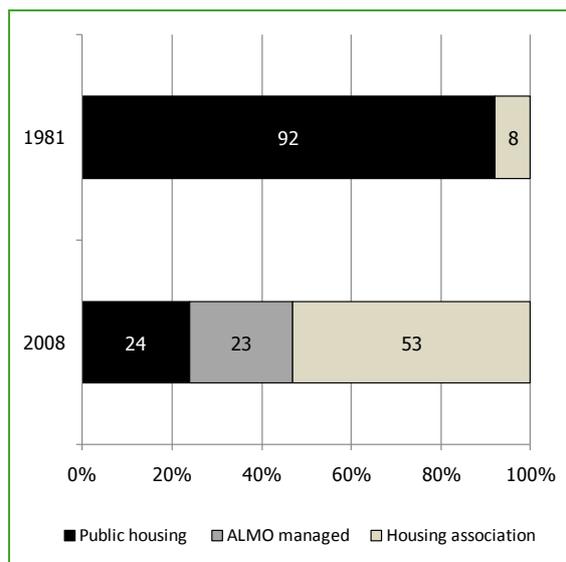
## 1.1 Social housing profile

Since devolution of power to Scotland, Wales and Northern Ireland in 1999, housing policy has differed across the kingdoms. This paper focuses on England where social housing transformation has been pushed further, and greater research data is available.

During the past three decades the proportion of social housing has fallen from over 30% to just below 20% of English households, mainly as a result of granting the 'Right to Buy' to sitting tenants in 1980. The composition of social housing has also changed significantly. Traditional 'council housing' owned, managed and financed in the public sector has fallen from 92% in 1981 to 24% in 2008 in England (see Figure 1). By contrast, the equivalent stock in the public sector was 55% in Scotland and 58% in Wales in 2008. These latter figures are not dissimilar to the 65% target in Australia.

In England, part of the decline in council housing is explained by the 23% of stock publicly owned, though managed by non-profit organisations run at arms' length from councils (ALMOs). However, the biggest change has been the increase from 8% (1981) to 53% (2008) in homes run by housing associations. Most association growth has been through the transfer of stock from councils. From the late 1990s, the stock transfer program accelerated through Large Scale Voluntary Transfers, mainly in urban areas (Pawson et al., 2009).

Figure 1: English social housing, 1981-2008



Source: Pawson et al. (2010).

## 1.2 Housing association growth

Housing associations are the dominant provider of English social housing. Although tracing their origins back several centuries, associations expanded rapidly after the Housing Act 1974 which provided generous public grants to build new social housing provided organisations registered with the Housing Corporation. Until late 2008 the Corporation, an arms' length national government agency with a separate board, acted as both funder and regulator of English associations. The Corporation also inspected associations until 2003 when it lost this role to the Audit Commission who also inspect local authorities and ALMOs.

Following the Housing Corporation's dissolution in December 2008, their investment role transferred to the Homes and Communities Agency (HCA), and was integrated with regeneration activities. Regulatory activities passed to the Tenant Services Authority (TSA), which later in 2010 will also regulate public housing and ALMOs. These changes to English regulation might lead to a re-ordering of the social housing sector with a more level playing field between types of provider, although it is too early to be certain (Gilmour, 2009)

There were 1,700 English housing associations employing over 133,000 staff as at March 2010. Most are small providers and manage fewer than 250 properties. Around 400 associations manage over 1,000 properties, accounting for 95% of the 2.4 million homes in the sector

(TSA, 2010a). Many associations concentrate on tenancy management, with only around 100 larger groups undertaking development. Merger between housing associations, and the relaxation in stock transfer size restrictions in 2004, has led to the growth of a small number of very large groups (Pawson & Sosenko, 2008). The 59 groups with more than 10,000 properties under management account for 44% of homes in the sector (TSA, 2010a).

### 1.3 Funding social housing

During the first half of the twentieth century, public grants rather than voluntary donations became the main funding source for social housing built by organisations other than councils. Grants to housing associations expanded after 1974, the most important type known since 1996 as 'Social Housing Grant'. The 1988 Housing Act introduced private finance, moving associations to a mixed model of public grants and private bank loans. The 2004 Housing Act allowed for-profit companies to bid against housing associations for Social Housing Grant, though few have chosen to.

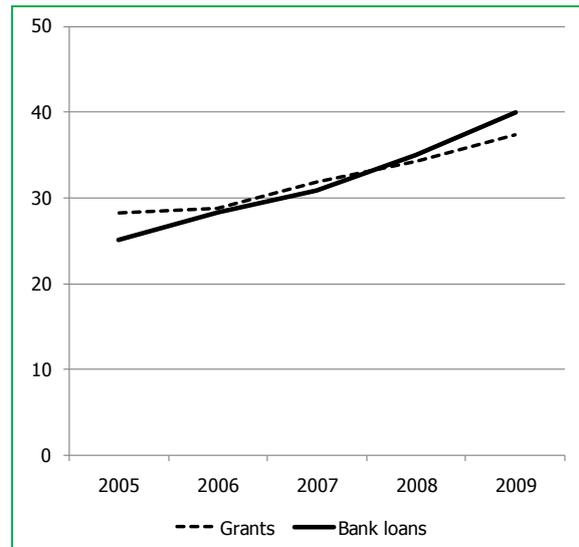
Most new housing association construction prior to 1988 was funded by public grant and a very limited amount of government debt. The past two decades have seen a dramatic rise in association funding, mainly through bank loans (see section 1.4). By 2008 the level of debt funding to associations exceeded public grants for the first time (Figure 2). Other forms of finance have become popular, including bond issues, use of the planning system, retained earnings and cross subsidy from property activities such as market sales (section 1.5).

Latest figures at March 2009 indicate drawn bank loans and bonds to English housing associations stand at £40 billion (\$70 billion). This is a significant increase of 15% from £35 billion (\$61 billion) in 2008. Since data was first consolidated for the sector in March 2002, bank loans have doubled from £20 billion (\$35 billion). Though the rate of increase in Social Housing Grant has been slower than the growth in bank lending, from Figure 2 both have increased over the last five years. Only to a limited extent has bank borrowing substituted for government grants.

The process of applying for and monitoring the use of Social Housing Grant is controlled by the HCA. The HCA negotiate with government on

the level of the Social Housing Grant and funding priorities, then seeks bids from associations looking to develop new affordable housing for rent or sale. Bids cover a three year period, currently 2008-2011, though further applications can be made under specific programs. Grants are awarded on a competitive basis, with those associations undertaking projects for the smallest grant usually receiving most of the government funding for new development (Whitehead & Williams, 2009).

Figure 2: Funding mix, 2005-9



Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March. Figures in £ billion.

### 1.4 Bank lending

The Housing Act 1988 created what would become a highly competitive market for lending to housing associations by banks and building societies until the GFC. Building societies are regulated mutual institutions initially established to write mortgages financed through retail deposits. Many building societies converted to banks during the 1990s.

The relationship between housing associations and banks is operated on a commercial basis. Associations decide how much they will borrow, from whom, what form that funding will take and what rate they will pay. While the TSA review treasury management as part of their assessment of financial viability, the regulatory provisions focus on ensuring a controlled approach to treasury risk rather than micro-managing their banking relationships.

Most housing associations have traditionally sought to match their long term assets with long term borrowing, and are able to arrange facilities which are repaid over a period of up to 30 years. These are longer loans than normally made available to commercial borrowers.

Housing association private finance is provided to the organisation as a whole on a 'global' basis, rather than for specific projects. Lenders look at the general strength of the borrower rather than cashflows associated with a particular project. Most loan agreements allow an association to draw down funds for any purpose that they can legally undertake. While England has adopted a limited number of project finance based models over the last two decades, these have mainly been used for local regeneration schemes, not new supply.

Lending to associations has become a mainstream banking activity, though as at December 2008, 85% of sector lending was dominated by just five large lenders (Table 1).

Table 1: UK loan facilities by lender, 2008

Lender	Status	£ billion
Lloyds/HBOS	Bank	13.6
Barclays	Bank	10.2
Nationwide	Building Society	9.3
Santander/Abbey	Bank	8.2
Royal Bank of Scotland (RBS)	Bank	8.0
Others		8.2

Source Social Housing (2009). Note table includes total bank facilities, not loans drawn. As at December 2008.

### *Risk mitigation*

The growth in lending to housing associations has occurred as they have become viewed as safe borrowers. Associations have stable social rent cash in-flows which are seldom subject to market volatilities as demand for social housing has always exceeded supply. Furthermore, as the subsidised rent levels are government regulated, and have increased at a slightly higher rate than inflation, associations benefit from some protection against the rising costs of providing housing services and repairs.

Banks are also protected as they are lending to regulated organisations. Although associations are not government guaranteed, market perceptions are that they will be supported:

'Moody's ratings in this sector continue to benefit from a strong regulatory framework and the embedded high probability of intervention from the government of the United Kingdom (Aaa/stable), were housing associations to face severe financial distress ... Moody's therefore expects that government will mobilize resources as necessary to protect tenants and to maintain the financial stability of the housing association sector, in order to maintain its key role in social policy' (Moody's, 2009: pp.1-2).

If the TSA is unhappy with an association's financial viability or governance, it can replace board members with nominees, remove failing executives, and place the troubled association on a stronger footing. If financial difficulties occur, the Regulator normally persuades a stronger association to take over the failing organisations. If this happens the bank loans are moved to the stronger association, thus avoiding lender losses. The Regulator can provide financial guarantees and additional grant to bail-out failing housing associations.

The effectiveness of regulation was shown late in 2007 when a London housing association, Ujima, was put under Housing Corporation 'supervision' as a result of financial difficulties and the prospect that it might breach funders' covenants (Cooper, 2007). The Regulator worked with Ujima's funders to find a solution to avoid funders using their contractual powers to call a loan default, potentially stepping in to take possession of the charged properties. In the event Ujima merged with L&Q, a large and financially robust London-based association. The transition was achieved in less than six weeks and no creditor lost money as a result of the association's failure.

### *Borrowing costs*

Loans to housing associations are typically charged at an all-in rate incorporating the cost of money to the lender and a margin based on the lender's perception of borrower risk. Cost of money is normally taken as three month LIBOR, the London Interbank Offered Rate. This is the rate UK banks borrow from each at other in the London money market. Most loans have a default interest rate which is variable but normally incorporate provisions allowing the rate to be fixed, or rate exposures hedged.

The all-in cost of borrowing for housing associations declined significantly between 1988 and 2008. This was driven by the appetite

of institutions to lend to the sector, which while not offering the highest return, had a low risk profile. This was reinforced by increasing familiarity with the sector, good performance of early loans, robust regulation and a complete absence of any loan defaults over two decades.

In the early 1990s margins on housing association loans were typically between 1.5% and 2%. Immediately prior to the GFC many associations could borrow at 0.25%, in some cases as low as 0.2%. It became common for associations to re-finance their debt several times to improve pricing. This competitive pricing by UK banks resulted in bonds, which are more complex and expensive to arrange than loans, playing only a modest role. The impact of the GFC is described in section 3.1.

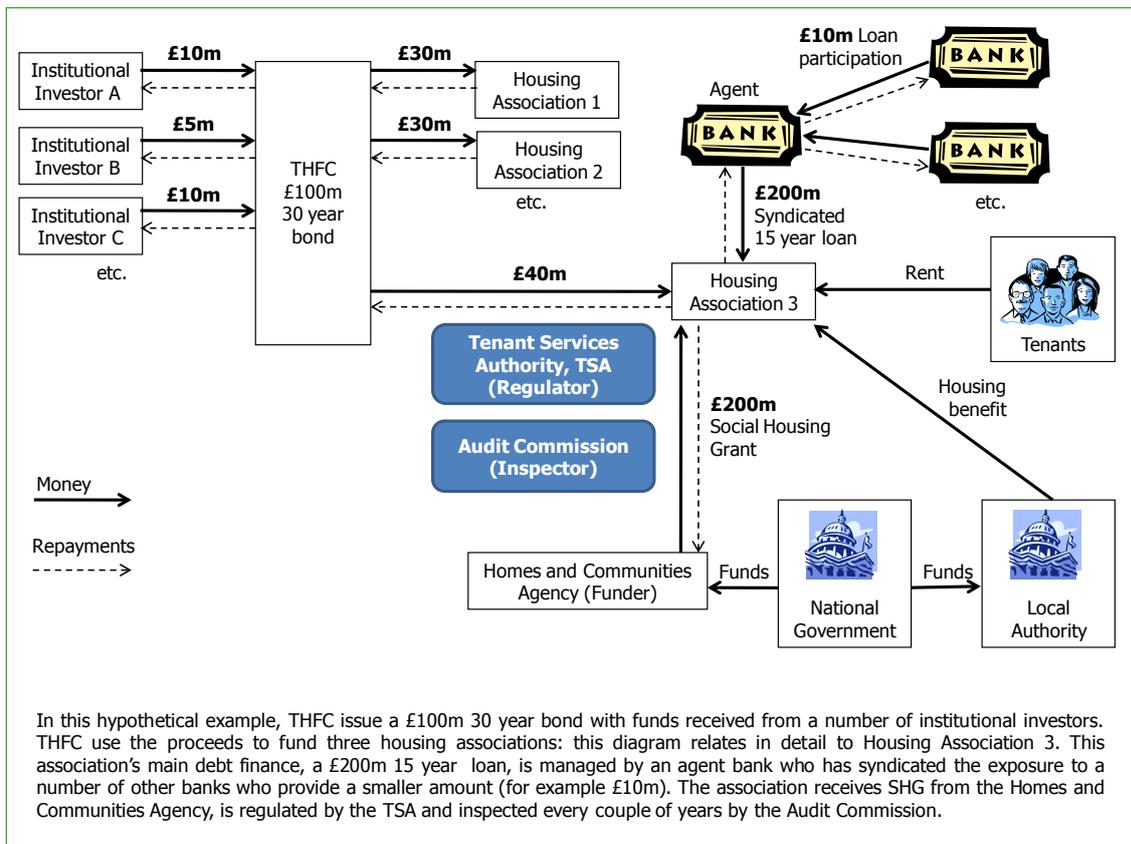
Lending to housing associations is characterised by only limited differentiation between weaker and stronger associations in terms of debt pricing. Consequently, an association with a strong balance sheet and track record could expect pricing broadly on a par with a riskier, less financially robust organisation.

### 1.5 Other private finance

Although much smaller in total amounts raised than bank loans, bonds offer an alternative long term debt source for associations. Bonds are purchased by institutional rather than private investors, and normally issued in a minimum size of £150 million (\$260 million). Bond investors pay less attention to the associations' underlying trading than banks, relying on regular assessments by rating agencies such as Moody's and Standard & Poor's (S&P).

While pricing and market conditions can critically influence investor appetite for bonds, the rating of individual English housing associations has remained relatively stable (Berry et al., 2004). Of the £5.7 billion (\$10 billion) bonds over £100 million in issue at November 2008, all had credit ratings in the range AA- to AAA Market perceptions are therefore that housing associations are of a 'high' or 'highest' credit rating with a 'very low' or 'minimal' credit risk (Gilmour et al., 2010).

Figure 3: THFC bond finance example



Source: Gilmour, T. in Lawson et al. (2010): p.14.

Larger housing associations can raise their own bond finance direct from the market. This can be attractive as a supplement to commercial loans as there are fewer limits on the size of a bond issue. In contrast banks will normally not take exposures to single counterparties through direct lending greater than £100 million (\$175 million). For example, Sanctuary Housing, who run 70,000 homes, raised £200 million (\$350 million) through a 30-year bond in March 2009 (Social Housing, 2009). Bond ratings of selected housing associations are shown in Table 2.

Table 2: Housing association bond ratings

Association	Stock	Rating
Sanctuary Group	70,000	Aa2 stable
Affinity Sutton	53,000	Aa2 stable
Places for People	53,000	Aa3 stable
Circle Anglia	52,000	Aa3 stable

Source: Moody's (2009) p.12 and websites of the associations for total housing stock managed. 'Rating' refers to long term debt status.

To assist medium-sized housing associations access bond finance, the Housing Corporation and the National Housing Federation – the sector's trade association – established the Housing Finance Corporation (THFC) in 1988. THFC is a syndicated bond vehicle, allowing investors to spread risk across a number of associations (see Figure 3). As at March 2009, THFC provided £1.9 billion (\$3.3 billion) of loans to 188 housing associations (THFC, 2009)

THFC is a non-profit organisation, operating without government control, subsidy or guarantee of indebtedness. Rather, THFC are assessed by credit ratings agencies and their bonds priced accordingly. S&P have rated THFC as 'A+ stable' rating over the last four years and maintained their rating in their latest 2009 review (THFC, 2010). All THFC assets are charged by fixed or floating security from housing association borrowers and available to support all THFC indebtedness. Therefore a single credit rating is given to THFC.

#### *Use of the planning system*

Section 106 of the Town and Country Planning Act 1990 allows councils to use controls over planning consents to obtain developer contributions on new property schemes. They are increasingly used to support the provision of services and infrastructure such as highways,

recreational facilities, education and, more recently, affordable housing (Whitehead, 2007).

Although there have been attempts in London and in some other cities to create a coordinated metropolitan approach, these attempts have generally failed as application of s.106 remains within an individual council's control. As such, there is no common model of how s.106 applies to affordable housing. The use of the planning system is limited during periods of economic dislocation when property prices fall, as there is little development gain (Gurran et al., 2007).

Some councils require a percentage of new developments to be affordable housing. In some cases, particularly where market rate housing is expensive, this allows affordable housing to be supplied without Social Housing Grant. In most cases, some level of grant is required to 'top up' the s.106 subsidy (Monk et al., 2005). Other local authorities do not want much (or any) affordable housing and use s.106 to raise income for other outcomes.

#### *Retained earnings*

The vast majority of English housing associations are charitable and prevented from distributing profits. However, many generate surpluses to undertake new developments, improve existing properties and support community initiatives. Associations can build their capital base through accumulating trading surpluses, and by revaluing their properties at current market values. Older assets, which were funded by low or zero debt, have a higher positive cashflow surplus per property.

#### *Cross subsidy*

Government policy since 1981 has encouraged English housing associations to offer shared ownership properties to diversity their affordable housing offering. Schemes involve the participant purchasing a share of a property at market prices, then renting the remaining share from a housing association at sub-market levels. The aim is for individuals to purchase a greater share of their property over time.

With shared ownership, the sale of the initial tranche of between 25% and 40% of the property value and to purchasers represents a revenue source for associations. As purchasers acquire a larger stake in the property, the association makes further capital gains. These profits can then be applied to meeting broader

social objectives. However, the timing of these cashflows to associations are unpredictable, as is the value which is determined by the prevailing market rates. Profits are greater during times of rising property prices.

More recently, several housing associations that develop new properties have taken advantage of profits generated from open market sales. The Regulator permits such sales provided they represent only a 'minority activity'. Use of cross-subsidisation has been one of the factors allowing a reduction in the amount of Social Housing Grant per new property developed.

The importance of market sales was confirmed in a recent research report (Gilmour et al., 2010). An interviewee noted that of the 1,300 properties developed each year by Affinity Sutton, a large housing association, one quarter are for market sales and shared ownership. Each sale is said to generate around £20,000 (\$35,000) profit. Some housing associations are said to have over half their new developments devoted to market sales and shared ownership.

## 1.6 Rental income

Rents on housing association have for nearly a decade been set by reference to a regulatory formula. This differentiates according to size and type of property, and links rents in a locality to both local average earnings and property prices (weighted 70:30). Rents differ markedly between different council areas, and are not linked to rent charged in the private sector. In areas of high housing demand, particularly London and the south east, social rents can be as low as 40% of market rents.

Annual changes to rent are linked to the Retail Price Index (RPI) measure of UK inflation, and increase annually by RPI plus 0.5% based on September price data. Due to a fall in RPI figures of 1.4% for the year to September 2009, housing association rents for March 2010-2011 will fall by 0.9% (TSA, 2009d).

### *Housing Benefit*

While housing association rents are lower than in the private sector, they are not affordable for all tenants. The use of welfare payments in the UK to low-income households to make rent affordable dates from 1919, although the system was reformed in 1982 with the move to 'Housing Benefit'. Only eligible rent is allowable

in the benefit calculations, therefore adjustments are required if the tenant's rent includes the cost of heating, lighting, water rates, meals or social service support.

Housing Benefit is a payment associated with an individual or household's needs, and is available to eligible applicants who rent from a private, housing association, public housing or ALMO landlord. Importantly, while renters in the private sector receive Housing Benefit as a welfare payment, in the social rental sectors payment is made direct to the landlord.

Across the social housing sector, 71% of tenants receive Housing Benefit (DWP, 2009a). Therefore for housing associations, around two thirds of their income will be protected through this welfare benefit reducing the risk of non-payment. However, benefit claims are bureaucratic and delays may occur in receiving funds. Claims are processed by councils, and performance standards vary across the country.

Table 3: Housing Benefit payments, 2009

Sector	Weekly	Annual
Private rental	£105 (\$184)	£5,480 (\$9,590)
Social rental	£72 (\$126)	£3,732 (\$6,530)

Source: (TSA, 2009e). Figures are for size of average claim for households eligible for Housing Benefit. Social rental sector includes public housing, ALMOs and associations. Figures as at December 2009.

From Table 3, Housing Benefit is a generous benefit compared to CRA in Australia. Some 4.5 million British households receive the benefit, at an annual cost to government of £16 billion (\$28 billion) in 2007-2008 (DWP, 2009a). Housing Benefit payments have risen in real terms over the last decade. In December 2009 government launched a consultation process with a view to reforming Housing Benefit to increase incentives for tenants to move off benefits and into employment (DWP, 2009b).

## 2 Recent Trends

This section uses data provided by the Housing Corporation, the TSA and independent research organisations to assess trends in the English housing association sector. The most useful publications are the annual 'global' accounts which consolidate data from all associations with over 1,000 properties. Latest data from March 2009 encompasses 95% of properties managed by housing associations (TSA, 2010a).

While 'global' accounts are helpful, they suffer from the effects of data aggregation. For example, they mask differences between those associations that have high and those that have low borrowing levels. Analysis is split in the accounts between two sub-sectors: 'traditional' and 'stock transfer' associations. The latter often have higher debt levels as many were required to borrow to 'buy' their stock from the local authority at the time of transfer.

### 2.1 Bank lending

The growth in bank lending is shown in Figure 2, increasing from £25 billion (\$44 billion) in 2005 to £40 billion (\$70 billion) in 2009. This significant change is somewhat distorting as it occurred at a time of large stock transfers to housing associations. With transferred stock came newly arranged bank loans.

Table 4: Debt per home, 2005-9

	2005	2006	2007	2008	2009
Stock, million	2.06	2.17	2.19	2.32	2.41
Loans, £ billion	25.10	28.33	30.90	35.00	40.00
Total debt per home, £	12,167	13,652	14,111	15,013	16,588

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March.

From Table 4, during the five years to March 2009 the number of homes managed by English housing associations increased from 2.06 to 2.41 million. The average debt per association property steadily grew during this period from £12,167 (\$21,292) to £16,584 (\$29,022). Though less than the percentage increase in total bank loans, the trend is still significant.

### 2.2 Income and expenditure

Revenues and costs for English housing association social housing letting activities are shown in Table 5. The trends are for year-by-year growing rental income and net surpluses, both in absolute terms and per property managed. In the year to March 2009 the average rental income per property was £3,794 (\$6,640) or £72 (\$126) per week. The surplus per property per week was £13 (\$23).

Table 5: Social housing P&L, 2005-9

£ millions	2005	2006	2007	2008	2009
Rents	6,766	7,369	7,504	8,231	9,151
Other income	372	416	335	316	333
<b>Turnover</b>	<b>7,138</b>	<b>7,785</b>	<b>7,839</b>	<b>8,547</b>	<b>9,484</b>
Costs (Table 10)	5,818	6,450	6,442	7,002	7,820
<b>Surplus</b>	<b>1,320</b>	<b>1,335</b>	<b>1,397</b>	<b>1,545</b>	<b>1,644</b>
Rent income per home, £ pa.	3,280	3,555	3,428	3,540	3,794
Surplus per home, £ pa.	640	644	638	665	682

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March. Figures in £ millions.

Table 6 includes the remaining revenues and costs other than those specifically associated with social housing activities (Table 5). Net profits from property sales were significantly lower in 2009 (£336 million, \$588 million) than 2008 (£577 million, \$1 billion) due to the effects of the GFC on market rate sales.

Table 6: Consolidated P&L, 2005-9

£ millions	2005	2006	2007	2008	2009
Surplus (Table 5)	1,320	1,335	1,397	1,545	1,644
Fixed asset sales	460	536	542	577	336
<b>Net income</b>	<b>1,780</b>	<b>1,871</b>	<b>1,939</b>	<b>2,122</b>	<b>1,980</b>
Interest receivable	147	147	131	192	192
Interest payable	-1,589	-1,671	-1,727	-1,957	-2,083
Other items	96	-37	-86	-38	114
<b>Total profit</b>	<b>434</b>	<b>310</b>	<b>257</b>	<b>319</b>	<b>203</b>
Net income per home, £ pa.	863	903	886	913	821
Total profit per home, £ pa.	210	150	117	137	84

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March. Figures in £ millions.

The sums generated from fixed asset sales in Table 6 are significant in comparison to sums generated through associations running their

affordable housing business. Lower asset sales are one factor leading to an increase in bank debt between 2008 and 2009. Associations have also been hit in 2009 by lower s.106 developer contributions as companies withdrew from several house development schemes.

### 2.3 Cashflow per property

The figures in section 2.2 relate to the global profit and loss account, and need to be adjusted to arrive at cashflow figures. In Table 7, depreciation is added back to net income as it is a non-cashflow item. Also, interest receivable is included as a cash inflow though interest payable is excluded from the totals.

Table 7: Cashflow per property, 2005-9

£ millions	2005	2006	2007	2008	2009
Rent surplus	1,320	1,335	1,397	1,545	1,644
Fixed asset sales	460	536	542	577	336
Depreciation	313	354	371	420	491
Interest receivable	147	147	131	192	192
<b>Total cashflow</b>	<b>2,240</b>	<b>2,372</b>	<b>2,441</b>	<b>2,734</b>	<b>2,663</b>
£					
Cashflow per home, pa.	1,086	1,144	1,115	1,176	1,104

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March.

From Table 7, the net cashflow per property has remained relatively steady over the last five years at around £1,100 (\$1,925). In real terms, the cashflow per property is therefore in modest decline – and in absolute decline between 2008 and 2009 as a result of the lower sales of properties during the GFC. Of the cashflow per property, 13% in 2009 (21% in 2008) relates to property sales. Without these asset sales, cashflow per property would be £964 (\$1,688) in the year to March 2009.

### 2.4 Interest cover

The annual global accounts of English housing associations pay particular attention to ability to service debt. The most straightforward measure adopted is the 'EBITDA' ratio, based on the operating surplus adjusted for depreciation, interest costs including capitalised interest, taxation and depreciation. After adjustments, the ratio compares the net surplus available to meet interest costs divided by actual interest paid (excluding capitalised interest). The ratio is

shown as a percentage, with a ratio of 100% the minimum needed to meet interest costs.

Housing associations vary in their accounting treatment of interest costs resulting from expenditure on major repairs. Some expense interest costs immediately through P&L, others capitalise some or all of the interest as a balance sheet item. The TSA favour their 'EBITDA MRI' ratio which strips-out capitalised interest on major repairs and treats it as if it had been expensed through the P&L account.

The final ratio in Table 8 is 'EBITDA MRIS' which is based on the previous adjustment for capitalised interest, though allows for the proceeds of asset sales to be included. This is the basis on which several bank loan covenants are calculated. Note that the results for 'EBIRDA MRIS' are not dissimilar to 'EBITDA'.

Table 8: Interest cover, 2005-9

EBITDA %	2005	2006	2007	2008	2009
Aggregate	136	125	118	114	113
Upper quartile	185	173	173	158	176
Median	142	134	131	124	129
Lower quartile	119	110	110	101	105
EBITDA MRI %					
Aggregate	113	99	89	86	85
Upper quartile	171	154	146	129	142
Median	127	117	110	102	105
Lower quartile	95	81	78	64	75
EBITDA MRIS %					
Aggregate	136	125	119	116	102
Upper quartile	163	170	174	166	155
Median	125	133	128	122	118
Lower quartile	88	97	98	93	91

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March.

Ratios are calculated for each individual housing association, then weighted based on the size of the association to form a sector total. Further ratios are calculated based on the median, representing the figure for the housing association in the middle of the distribution of ratio results. 'Upper quartile' ratios are based on results in the top 25% of the distribution, and 'lower quartile' in the lower 25%.

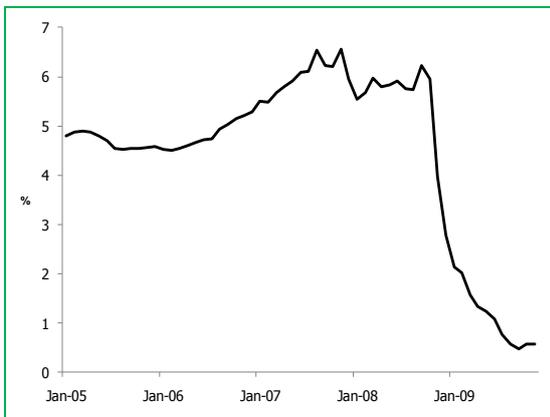
Table 8 presents a complex analysis of interest rate cover ratios. One initial comment is that all the ratios in the table, however calculated and for all sections of the sector, are lower than

would be achieved by borrowing from banks in Australia. Taking the median ratio as a benchmark, interest cover for English housing associations is 129% on a basic EBITDA calculation, 105% adjusting for capitalised interest, and 118% adjusting for capitalised interest but allowing for asset sales.

The lower income from asset sales in the year to March 2009 has narrowed the gap between 'EBITDA MRI' and 'EBITDA MRIS' ratios. Despite this convergence, substantial gaps remain between upper and lower quartile ratios across all measures of interest cover. This is probably explained by varying level of efficiency between organisations, and possibly scale issues.

Despite the significant increase in debt between 2008 and 2009 shown in Figure 2, interest cover ratios have only been moderately affected. This is mainly due to 'all-in' interest rates falling due to government policy in lowering market interest rates such as LIBOR during the GFC. Rates in 2008-9 were 5.9%, compared to 6.3% in 2007-8 (TSA, 2010a):

Figure 4: Three month LIBOR, 2005-2009



Source: Bank of England (2010)

During the period 2005 to 2009, interest cover has generally fallen, though there is little evidence that it has reached levels to be of concern to lenders. Where the ratio is under 100%, associations are failing to generate enough cash from regular activities to meet their interest obligations. In part this may be because they are catching up with repairs. The Regulator seldom comments on what EBITDA ratio is appropriate, though indicated 'the 110% indicator [is] often set for a reasonable interest cover ratio' (Housing Corporation, 2007a: p.36).

The low interest cover ratios characteristic of bank lending to English housing associations are different to those available for private sector property companies. This is due to the nature of the associations' predictable income, lower risk structure and taxation status:

'Property companies tend to be run with high margins, reflecting the risk arising from requiring a high level of capita. The amount of capital required, means that the returns on it are fairly low, despite the high margin ... However, the RSL [housing association] sector generates a low return with low margins and high capita. This is as a result of several factors: the predictability of much of the income stream through high demand and government backed revenues, rent limits and potentially the absence of profit distribution meaning the same investment can be achieved from less surplus. As a result of this relative security, lenders are willing to tolerate lower levels of interest cover from RSLs than from the wider property sector' (TSA, 2010b: p.9).

## 2.5 Asset values and gearing

The balance sheet information in Table 9 shows the capital position of the sector. Property assets owned by housing associations grew significantly over the five years to March 2009, from £64 billion (\$112 billion) to £95 billion (\$166 billion). These numbers equate to a rise in the average value of an association home from £31,098 (\$54,433) to £39,207 (\$68,612).

Table 9: Balance sheet items, 2005-9

£ millions	2005	2006	2007	2008	2009
Property assets	64,156	70,295	77,426	85,164	94,567
Reserves	10,985	12,532	13,573	14,405	16,106
Average property value, £	31,098	33,910	35,370	36,630	39,207
Adjusted net leverage %					
Aggregate	31	33	34	35	36
Upper quartile	20	22	21	21	22
Median	27	29	29	32	34
Lower quartile	35	37	38	39	41

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March.

Asset values in Table 9 are affected by the accounting treatment of residential property. From 2008 to 2009 there was an increase in the proportion of social housing assets held at

market valuation rather than historic cost, from 20% to 25%. However, 75% of homes remain valued at historic cost which explains the relatively modest average property values.

The figures for net leverage (gearing) in Table 9 are also impacted by asset valuation methods. Hence the leverage ratios would be lower if all properties were valued at current market prices. There has been a steady increase in sector gearing levels, with the median rising from 27% in 2005 to 34% in 2009. However, the main restraining factor remains interest cover rather than gearing:

'The RSL [housing association] sector is generally fairly lowly geared as a result of high grant levels funding the majority of stock, and rising property values increasing the value of available security. The limiting factor for the sector's borrowing at present is therefore its ability to meet debt interest and capital payments as they fall due' (TSA, 2010: p.55)

## 2.6 Tenancy management costs

English housing association global returns allow a break-down of tenancy and property management costs across the sector. In Table 10, various cost items are analysed.

Table 10: Social housing costs, 2005-2009

£ millions	2005	2006	2007	2008	2009
Management cost	2,232	2,515	2,515	2,790	3,070
Routine maint.	1,198	1,268	1,306	1,428	1,602
Planned maint.	488	568	562	614	706
Major repairs	860	1,041	1,044	1,146	1,218
Bad debts	67	72	72	76	86
Other costs	660	662	572	528	647
<b>Cashflow costs</b>	<b>5,505</b>	<b>6,096</b>	<b>6,071</b>	<b>6582</b>	<b>7329</b>
Depreciation	313	354	371	420	491
<b>Total costs</b>	<b>5,818</b>	<b>6,450</b>	<b>6,442</b>	<b>7,002</b>	<b>7,820</b>
Management costs per home, £ pa.	1,082	1,213	1,149	1,200	1,273
Maintenance per home, £ pa.	817	1,373	1,330	1,371	1,462
Repairs per home, £ pa.	417	502	477	493	505
Cashflow costs per home, £ pa.	2,668	2,941	2,773	2,831	3,039
Total costs per home, £ pa.	2,820	3,111	2,943	3,012	3,242

Source: Housing Corporation (2008a), TSA (2010a). Data as at 31 March. Maint. = maintenance.

From Table 10, between 2008 and 2009 there has been significant cost pressure on housing associations, with expenditure per home increasing 'well above' general price increases in the economy (TSA, 2010a: p.26). More encouragingly, tenancy voids (2.15%) and bad debts (1%) are at historically low levels.

The rent formula described in Section 1.6 above will produce a reduction of rents per household of 0.9% in 2010-2011. This was based on data when the UK was experiencing price deflation between January and November 2009. Latest information is that inflation has returned, with the RPI increasing by 5.3% in the year to April 2010 (ONS, 2010). Housing associations will therefore be faced with declining profitability in 2010-2011 as income per home falls while management and property costs per home rise.

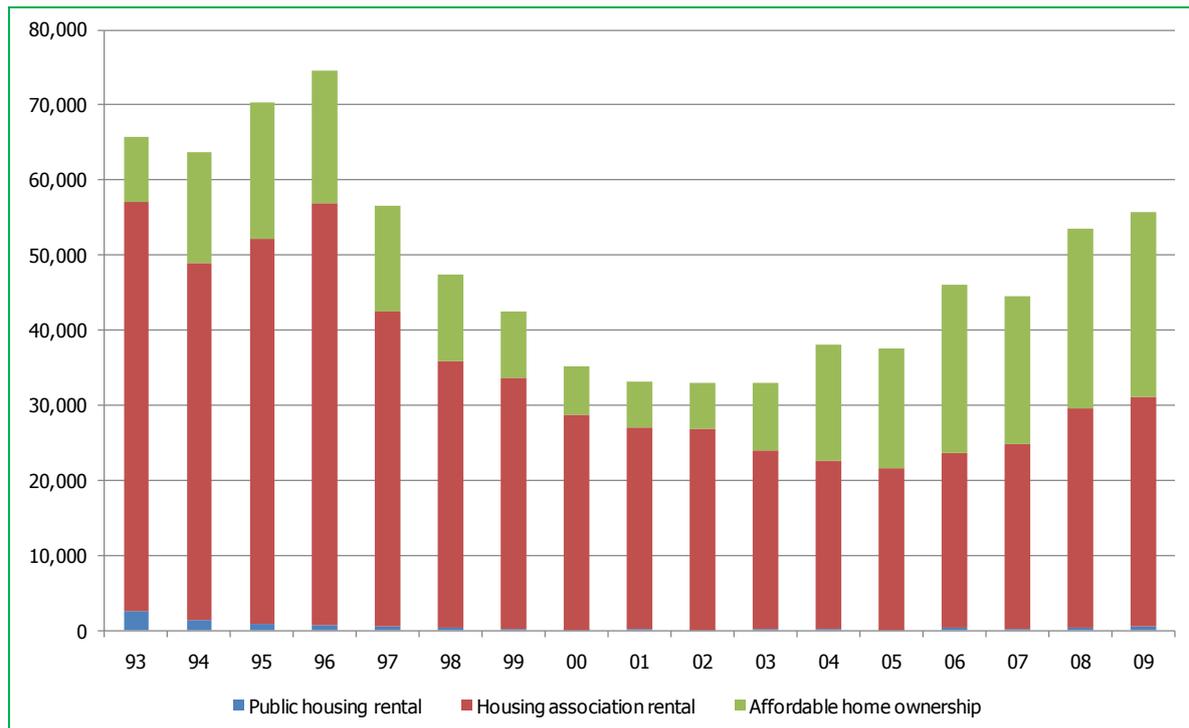
## 2.7 Growth in dwelling stock

The increase in affordable homes, either through new build, or acquisition from the private sector, is shown in Figure 5. These numbers exclude both transfers from the public housing to housing association sectors, and the effects of the Right to Buy public housing. Hence Figure 5 shows additional affordable homes produced through various grant programs and by using private finance.

Since 2000, the number of new social rental housing has been under 30,000 dwellings per year – lower than annual production in the early 1990s which was regularly over 50,000. There has been a steady rise in new production since 2004, including the 2008-09 period which was affected by the GFC. The vast proportion of new supply is by housing associations rather than public housing. The number of new public housing dwellings constructed fell from 2,580 in 1993 to a low of just 60 in 2002. Recent policy changes have allowed councils to build new public housing – 570 units were built in 2009.

Housing associations are substantial property developers. Of their new rental properties made available in 2009, 89% were developed by associations and 11% bought from the private sector. Some of the latter properties were acquired as part of the government's response to the GFC. Section 106 developer contributions funded 440 new-build homes during 2009.

Figure 5: Affordable housing supply, 1992-2009



Source: Data obtained from CLG (2010a). Dates are shown for the year to March.

During the last six years a change in policy has led to a greater emphasis on low cost home ownership, shown in green in Figure 5. The majority of these schemes are run by housing associations. In the year to March 2009 some 1,710 properties were made available through shared ownership and 22,970 through low cost home ownership schemes selling to a discount to market. Of the 55,770 affordable homes produced in 2009, 56% were for social rental and 44% for low income home purchase.

new homes supplied (CLG, 2009). Difficult property market conditions and lack of credit availability have led to a sharp fall in Right to Buy sales, down to 7,300 in 2009.

The increase in affordable supply shown in Figure 5 is impressive in contrast to Australia, and relatively steady through economic cycles. However, overall UK housing supply continues to fail to meet demand, giving price pressure in a number of regions (Barker, 2004). English housing supply in 2009 was only 166,570, 20% down on the previous year (CLG, 2010b).

A further backdrop to Figure 5 is the loss of social housing through Right to Buy sales to sitting tenants. The apply to public housing tenants, and public housing tenants that have been transferred to a housing association. In each year to 2007 Right to Buy sales exceeded the increase in new affordable housing. In 2004, for example, 88,330 social rental homes were sold to sitting tenants compared to 22,660

## 3 Analysis

England's reform of social housing delivery and funding has involved a fundamental shift from public sector models to those using non-profit organisations and private finance. This section considers whether the English model is robust and sustainable, based on an analysis of the impact of the GFC. It also reviews specific aspects of interest to Australian policy setting.

### 3.1 Effect of the GFC

In the decade to 2008, housing associations operated in a favourable economic environment with rising property prices, low cost inflation and reducing rates on bank loans and bonds. The sector grew substantially through public housing stock transfer, and had sufficient funds to bring over 90% of their stock to 'Decent Homes' standards by March 2009 (TSA, 2010a).

The operating environment for associations is now very different. Triggered by the US sub-prime mortgage collapse in 2007-2008, a series of events often known as the Global Financial Crisis (GFC) have brought turmoil to property and financial markets. It led to the failure of a number of UK financial institutions and their rescue by governments, most notably RBS and Lloyds/HBOS – major lenders to housing associations (Table 1). There have also been falls in property and stock markets, lack of liquidity in financial markets making borrowing harder and more expensive, a decline in economic activity, and rises in national debt.

The impact of the GFC has not been uniform across developed countries. Furthermore, the degree to which affordable housing provision has been affected has been strongly mediated through the design of a particular country's financing approach (Lawson et al., 2010, forthcoming). In particular the mix between debt, equity and grant in funding affordable housing, and the extent governments implicitly or explicitly underwrite finance obligations.

For several months during 2008 many English lenders stopped making new loans to housing associations due to liquidity constraints and concern over property related risk. This was followed by a period when considerably higher

margins were charged on new and re-negotiated loans. RBS revealed in November 2008 that their margins on housing association lending had risen from around 0.3% before the GFC to over 1.5% in 2008 (Dowler, 2008). Interviewees during November 2009 confirmed margin increases, citing 2% as a typical rate. This brought margins back to where they had been in the mid 1990s, before competition between lenders led to price cutting.

Despite the rise in margins on bank loans, all-in rates paid by associations fell due to reduction in the cost of money (LIBOR) as government stimulated the economy. LIBOR fell from 6% in mid 2008 to 0.6% in September 2009 and has remained at that level since (Figure 4). One result of the re-pricing of bank margins during the GFC has been the increasing attractiveness of housing association bond issues. Several larger associations, and The Housing Finance Corporation – a non-profit bond syndicator – issued significant new bonds during 2009-2010 with pricing and terms often better than bank loan facilities (Gilmour et al., 2010).

English housing associations have been more hit by the property than the finance impacts of the GFC. Reliance on the planning system and cross-subsidy from market rate sales has made associations more dependent on a buoyant private property market, and the property crash of the last 18 months has provided new challenges (Cooper, 2009). Developing housing associations who rely on market-rate sales to part fund affordable housing were said in June 2008 to be falling short of the Regulator's target for new building (Inside Housing, 2008).

'Compared to the wider economy and the property sector in particular, the RSL [housing association] sector has experienced less instability and maintained steady growth. Where property companies have had to make substantial write-downs to their assets and the margins in the wider economy have been squeezed, the RSL sector has been largely insulated by high and rising demand, the security of income streams and the flexibility to move property between tenures to maintain cash flow. Asset write-downs in the RSL sector represent only around 0.1% of balance sheet values' (TSA, 2010b: p.5).

Where associations held assets valued at market, including land-banks and properties for sale, the fall in property values needs to be

reflected in their accounts. In the year to March 2009, asset write-downs were £159 million, \$278 million (TSA, 2010a). These adjustments were less than faced by the private sector, as noted in the text box on the previous page.

Asset write-downs, coupled with lower income from market rate sales and shared ownership schemes, could trigger a breach of bank covenants. This could lead to a refinancing risk if the bank was unwilling to continue with the loan. It would probably also result in higher bank lending margins. Widespread housing association failure would reduce confidence in the sector, and endanger social tenancies.

To mitigate this risk, the TSA provided grants to certain associations to enable them to change the tenure of some stock from sale (which is exposed to market value reductions) to social rent (which is not). The cost to government is estimated to have been £2.8 billion (\$4.9 billion) to the end of 2008. Several of the largest recipients of this bail-out required over £250 million (\$438 million) to maintain their solvency (Inside Housing, 2009: p.9).

Therefore even in England, where much affordable housing finance has been left to the market without formal guarantees, during the GFC the government has had to step-in. This reinforces the opinion given by Moody's, shown in a text box on page 7, that governments will stand by the sector. England's experience is similar to the US, another country that despite using non-guaranteed private finance for affordable housing required government funding to rescue their tax credit scheme (Joint Centre for Housing Studies, 2009).

### 3.2 Private finance capacity

With strong government support for the housing association sector during the GFC, despite the UK facing severe dislocation in property and financial markets private finance has remained available to associations except for a short period. The Regulator reports that 'access to private finance remains good for the sector, with Finance Directors reporting positive discussions with lenders' (TSA, 2009b: p.1).

Forecast requirements for private sector finance required by English housing associations are shown in Table 11. The amount peaks in the year to March 2010 at £5.14 billion (\$9 billion), with a total estimated requirement over five

years of just under £20 billion (\$35 billion). To sustain current delivery levels of new housing, particularly from 2012-2015, the TSA (2009a) estimate that the actual finance requirement may be nearer £25 billion (\$44 billion).

Table 11: Private finance forecast, 2010-14

£ billions	2010	2011	2012	2013	2014
New housing cost	7.05	5.61	4.49	3.74	3.56
Sales receipts	-0.89	-0.92	-0.82	-0.82	-0.75
Grants	-2.81	-2.51	-2.14	-1.79	-1.56
<b>Net cost</b>	<b>3.35</b>	<b>2.18</b>	<b>1.53</b>	<b>1.13</b>	<b>1.25</b>
Major repairs	0.47	0.49	0.57	0.68	0.82
Loan repayments	0.82	1.07	1.12	1.22	1.01
Stock transfers	0.30	0.20	0.20	0.20	0.20
Other funding	0.20	0.20	0.20	0.20	0.20
<b>Finance needed</b>	<b>5.14</b>	<b>4.14</b>	<b>3.62</b>	<b>3.43</b>	<b>3.48</b>

Source: TSA (2009a) p.9. Data for 12 months to 31 March.

The sector has approximately £14 billion (\$25 billion) of committed bank facilities that have not been drawn. A portion, but not all of these facilities, could be used towards the projected funding requirement. TSA discussions with financiers in 2009 suggested that over the five years to March 2014 there was an appetite for £20 billion (\$35 billion) of bank lending to the sector and £5-10 billion (\$9-18 billion) from the bond market (TSA, 2009a). This will cover the forecast requirement in Table 11.

### 3.3 Association borrowing limits

In 2007 the then Regulator, the Housing Corporation published a controversial report 'Unlocking the door'. This outlined their view of optimal housing association capital structures by 'examining how much further the financial capacity of housing associations could be stretched to take on additional debt ... [to promote] a further shift in the balance between government funding and private borrowing' (Housing Corporation, 2007c: p.3).

The report was based on modelling by Grant Thornton that calculated 'free cashflow' in the sector, i.e. cashflows not used for operational purposes or capital expenditure (Housing Corporation, 2007b). This cashflow was then used to pay interest at 7% on new debt, though not make loan repayments. It was estimated that associations could increase debt by £4.6 billion (\$8 billion), or by £6.8 billion (\$12 billion) taking into account profits

generated through market sales. This would reduce the amount of Social Housing Grant required for new developments by 10%-20%.

The approach in 'Unlocking the door' has a number of risks. Higher debt would lead to associations having lower interest cover ratios, potentially leading to a breach of existing loan agreements. The ability of developing housing associations to maintain landbanks to facilitate future housing development, and fund community schemes, may be curtailed. Hence the 2007 report was unpopular with the sector.

A recent survey re-visited the idea of increasing debt levels (TSA, 2010a). It found that since 2006 free cash levels had declined, in part due to paying interest on an additional £12 billion (\$21 billion) of bank loans. Due to the effects of the GFC on cashflow, and the need for further investment in stock refurbishment, the Regulator considers 'it is, therefore, desirable to maintain some free cash to permit flexibility of response' (TSA, 2010a: p.60). This suggests current debt levels are as high as is prudent.

### 3.4 Employment impact

Improvements made to the management and delivery of affordable housing could, in theory, pay dividends in terms of higher employment and reduce anti-social behaviour on housing estates. Though the links between housing and employment are intuitive, only limited academic study has been undertaken. Dutch research has established that male unemployment has a negative impact on the chances of living in high quality housing (Feijten & Mulder, 2005). Proving the converse, that higher quality housing reduces unemployment, is much harder as other factors may be important.

In England 'worklessness' was established by the government as a policy priority during the last decade. In part this was prompted by a major increase in people claiming incapacity benefit which was seen as easier to apply for than unemployment benefit. Research indicates 4.35 million people of working age and 1.8 million children lived in English households where no adult worked (Housing Corporation, 2008b). These 'workless' households tend to be concentrated in neighbourhoods facing deep-rooted poverty and other issues (TSA, 2010d).

A major review in 2009 identified ways that local government and their partners – typically

housing associations – could help address the problem (Houghton, 2009). 'Worklessness' has become seen in England as a problem facing housing associations running large estates transferred from the public sector, and one that they need to take steps to find solutions to:

'Housing and employment are closely linked: the need for a decent home is fundamental to employment and training opportunities and the ability to work – by tackling worklessness, housing providers can offer a springboard to other opportunities for residents. From a business perspective, a high level of workless households in an area can result in difficulties for the housing association to deliver sustainable regeneration' (TSA, 2010d).

In 2008 the NHF published a survey of the non-housing community benefits provided by their members. This indicated that associations undertook 6,800 projects worth £435 million (\$760 million) that contributed to the social and economic sustainability of neighbourhoods during 2006-07. These projects were said to benefit 5.5 million people (NHF, 2008).

Of these community projects run by housing associations, just under 10% aimed to increase local employment. An estimated 67,000 people were said to benefit. Typical projects included:

- Developing building trade skills, including employing tenants to help with construction.
- Working with local businesses to encourage employment of association tenants.
- Providing work experience for tenants, and issuing certificates for skills gained.
- Bidding for government funding for special projects relating to problem neighbourhoods.
- Assisting with local business start-ups, including helping establish social enterprises.
- Training tenants in mystery shopping techniques to build their skills (NHF, 2008).

The role of associations in employment initiatives is characterised by close partnership working the local council, employers, job agencies and social service departments. These partnerships are often spatially focused on neighbourhoods in need, and the chosen solutions respond to the characteristics and issues of particular areas (NHF, 2009). One

benefit of associations being involved is that they are more locally connected than a housing provider covering a larger area.

The employment generating activities of English housing associations could in theory have been undertaken by local councils if they still owned public housing. However, there appears to have been a more concerted effort by associations to engage in community regeneration projects. This is a particular characteristic of 'second generation' stock transfer housing associations who inherited public housing located in more challenged urban estates (Pawson et al., 2009)

### 3.5 Transparency and benchmarking

A defining characteristic of English housing association regulation compared, for example, to the US or Australia, is the collection and publication of a wealth of information (Gilmour, 2009: p.34). This is an example of New Public Management approaches whereby public and non-profit organisations have to apply similar principles to disclosure of organisational and financial information to public companies.

English associations complete Regulatory and Statistical Returns (RSRs), conduct tenant surveys and publish accounts in accordance with accounting rules each year (Housing Corporation, 2006). These reports, together with periodic Audit Commission inspection reports and annual Housing Corporation Assessments of risk, are available on readily accessible official websites. Reports are not required if providers have fewer than 25 properties, and are shorter for less than 1,000.

'One of the ways we assess how well social housing providers are performing is through their annual reports. The level of assurance that we gain from this self-assessment will be influenced by the degree to which providers are transparent, involve their tenants in scrutinising performance and adopt external validation such as benchmarking, peer review and third party accreditation' (TSA, 2010d).

The transparency guidelines developed over the last decade by the Housing Corporation have been continued by its successor Regulator, the TSA. Disclosure rules now apply to all affordable housing providers, whether in the public, private or non-profit sectors. They also apply to the Regulator: 'the TSA is committed

to being transparent in our approach to assessing regulatory performance' (TSA, 2010c).

The use of transparency in housing association reporting has been closely linked with the growth of performance benchmarking. Since 2001 the Regulator has collected and publicised 30 Performance Indicators for associations collected (Housing Corporation, 2005). These include a range of indicators on lettings, costs, repairs, finances and tenant satisfaction.

'The Housing Corporation collects performance information from associations to check that the sector is viable, well governed and well managed, is delivering the government's policy objectives, is worthy of further investment and is working towards continuous improvement' (Housing Corporation and HouseMark, 2003).

Collecting consistent performance information for all the medium and large associations allows calculation of average scores. These could be national, or regional where cost differences are significant. Individual associations can therefore be assessed by the Regulator in comparison to their peers. This can be used to drive efficiency gains in the sector, reduce costs and encourage higher levels of customer service.

The pressure on associations to improve performance has led to a growth in specialist support organisations. The most prominent is 'HouseMark', established in 1999 by the NHF and Chartered Institute of Housing. With 860 members, HouseMark is both a peer network sharing best practice and a provider of fee based consultancy services (HouseMark, 2010).

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