Communities and Local Government

Impact Assessment for Affordable Rent

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Contents

Title: **Affordable Rent** **Lead department or agency:** Department for Communities and Local Government **Other departments or agencies:** Homes & Communities Agency	**Impact Assessment (IA)** **IA No:** 39 **Date:** 9/06/2011 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Other **Contact for enquiries:** Robert Dryburgh 030344 43791

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

England faces substantial levels of unmet housing need. Need is a subjective concept but, according to recently published research, it is projected that around 1.9 million households currently experience some form, including overcrowding, concealed households and unsuitable accommodation. Forecasts suggest that affordability will remain challenging; the average lower quartile home now costs over six times household income (and eight times in London). Given the scale of these problems, Government intervention remains essential to meeting the housing needs and aspirations of a large section of the population. Reform is necessary to ensure that government intervention can reduce housing need while delivering better value for money, making better use of constrained capital expenditure.

What are the policy objectives and the intended effects?

The Government's intended policy objectives are:

- to maximise the delivery of new social housing, making the best possible use of constrained public subsidy and the existing social housing stock over the next Spending Review period, and matching delivery of new build to areas of housing need; and

- to provide an offer which is more diverse for the range of people accessing social housing, providing alternatives to traditional social rent and making the provision of social housing more flexible. The measures announced at Spending Review 2010, including Affordable Rent, will deliver up to 150,000 new affordable homes.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

This impact assessment assesses three options, although a wider range of options has been considered in developing the new Affordable Rent model. More information is contained in the evidence base section. The options considered in this impact assessment are:

1. No policy change: continuation of the National Affordable Housing Programme in its current form.

2. Reform the delivery of affordable housing by introducing Affordable Rent, assuming that 100 per cent of available funding is used to deliver Affordable Rent units.

3. Reform the delivery of affordable housing by introducing Affordable Rent, assuming that a proportion of available funding is used to deliver low cost home ownership where this this is appropriate for local circumstances and helps promote overall delivery of affordable housing. This is the preferred option on the basis of the overall costs and benefits set out in this impact assessment.

Will the policy be reviewed? It will **If applicable, set review date:** Month/Year

What is the basis for this review? Sunset clause/Duty to review/PIR/NA **If applicable, set sunset clause date**

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Ministerial Sign-off For final proposal stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible minister: .... Date: 9 June 2011 ....

Summary: Analysis and Evidence

Policy Option 1

Description:

Continuation of the National Affordable Housing Programme

Price Base	PV Base	Time Period	Net Benefit (Present Value (PV)) (£m)		
Year 2011	**Year** 2011	**Years** 30	**Low:** £1,168m	**High:** £2,166m	**Best Estimate: £1,649m**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

This IA estimates monetised effects in terms of economic benefits net of resource costs. Net government costs, representing transfers excluded from the above figures, have been estimated in NPV terms as: grant payments to affordable housing providers (£1,586m); increases in Housing Benefit payments (-£625m); employment and council tax related costs (-£212m).

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low			£52m	**£1,168m**
High			£94m	**£2,166m**
Best Estimate			£72m	**£1,649m**

Description and scale of key monetised benefits by 'main affected groups'

Net economic benefit of increased use of land for housing: £517m (shared between consumers, landowners and government). Social benefits of improved consumption for low-income households: £540m. Benefits for UK producers from increased housing construction output: £592m.

Other key non-monetised benefits by 'main affected groups'

Reductions in housing need, including overcrowding, sharing, concealed households, unsuitability and unnaffordability problems, for households in England. Improved prospects for home ownership amongst first time buyers.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5%

Appetite among affordable housing providers and lenders for development is uncertain, as are economic conditions relating to interest rates and housing scheme costs. This IA provides a range of scenarios relating to these variables and the scale of delivery achievable. The impact of affordable housing delivery on housing supply and economic output is uncertain and determines the scale of economic and exchequer benefits associated with development. The types of household provided with affordable housing determines the Housing Benefit and distributional implications of policy options - this is subject to local discretion.

Direct impact on business (Equivalent annual) (£m):			**In scope of OIOO?**	**Measure qualifies as**
Costs:	**Benefits:**	**Net:**	No	NA

Enforcement, Implementation and Wider Impacts

<table>
<tr><td colspan="2">What is the geographic coverage of the policy/option?</td><td colspan="3">England</td></tr>
<tr><td colspan="2">From what date will the policy be implemented?</td><td colspan="3">01/04/2011</td></tr>
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<tr><td colspan="2">What is the CO_2 equivalent change in greenhouse gas emissions?
(Million tonnes CO_2 equivalent)</td><td>Traded:</td><td colspan="2">Non-traded:</td></tr>
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<tr><td colspan="2">What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?</td><td>Costs:</td><td colspan="2">Benefits:</td></tr>
</table>

Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	Yes/No	Yes/No	Yes/No	Yes/No	Yes/No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	Yes	49
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	49
Small firms Small Firms Impact Test guidance	No	49
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	50
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	50
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	50
Human rights Human Rights Impact Test guidance	No	50
Justice system Justice Impact Test guidance	No	50
Rural proofing Rural Proofing Impact Test guidance	No	50
Sustainable development Sustainable Development Impact Test guidance	No	51

[1] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 2

Description:

Price Base Year 2011	PV Base Year 2011	Time Period Years 30	Net Benefit (Present Value (PV)) (£m) Low: £1,759m	High: £4,696m	Best Estimate: £2,966m

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

This IA estimates monetised effects in terms of economic benefits net of resource costs. Net government costs, representing transfers excluded from the above figures, have been estimated in NPV terms as: grant payments to affordable housing providers (£1,586m); increases in Housing Benefit payments (£482m); employment and council tax-related costs (-£305m).

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			£77m	**£1,759m**
High			£198m	**£4,696m**
Best Estimate			£127m	**£2,966m**

Description and scale of key monetised benefits by 'main affected groups'

Net economic benefit of increased use of land for housing: £928m (shared between consumers, landowners and government). Social benefits of improved consumption for low-income households: £985m. Benefits for UK producers from increased housing construction output: £1,052m.

Other key non-monetised benefits by 'main affected groups'

Reductions in housing need, including overcrowding, sharing, concealed households, unsuitability and unaffordability problems, for households in England.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5%

Appetite among affordable housing providers and lenders for development is uncertain, as are economic conditions relating to interest rates and housing scheme costs. This IA provides a range of scenarios relating to these variables and the scale of delivery achievable. The impact of affordable housing delivery on housing supply and economic output is uncertain and determines the scale of economic and exchequer benefits associated with development. The types of household provided with affordable housing determines the Housing Benefit and distributional implications of policy options - this is subject to local discretion.

Direct impact on business (Equivalent annual) (£m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	NA

Enforcement, Implementation and Wider Impacts

<table>
<tr><td colspan="2">What is the geographic coverage of the policy/option?</td><td colspan="3">England</td></tr>
<tr><td colspan="2">From what date will the policy be implemented?</td><td colspan="3">01/04/2011</td></tr>
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</table>

Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	Yes/No	Yes/No	Yes/No	Yes/No	Yes/No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
Statutory equality duties[2] Statutory Equality Duties Impact Test guidance	Yes	49
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	49
Small firms Small Firms Impact Test guidance	No	49
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	50
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	50
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	50
Human rights Human Rights Impact Test guidance	No	50
Justice system Justice Impact Test guidance	No	50
Rural proofing Rural Proofing Impact Test guidance	No	50
Sustainable development Sustainable Development Impact Test guidance	No	51

[2] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 3

Description:

Price Base Year 2011	PV Base Year 2011	Time Period Years 30	Net Benefit (Present Value (PV)) (£m)		
			Low: £1,932m	High: £4,880m	**Best Estimate: £3,233m**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

This IA estimates monetised effects in terms of economic benefits net of resource costs. Net government costs, representing transfers excluded from the above figures, have been estimated in NPV terms as: grant payments to affordable housing providers (£1,586m); increases in Housing Benefit payments (£553m); employment and council tax-related costs (-£358m).

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			£83m	**£1,932m**
High			£202m	**£4,880m**
Best Estimate			£136m	**£3,233m**

Description and scale of key monetised benefits by 'main affected groups'

Net economic benefit of increased use of land for housing: £1,086m (shared between consumers, landowners and government). Social benefits of improved consumption for low-income households: £905m. Benefits for UK producers from increased housing construction output: £1,241m.

Other key non-monetised benefits by 'main affected groups'

Reductions in housing need, including overcrowding, sharing, concealed households, unsuitability and unaffordability problems, for households in England. Improved prospects for home ownership amongst first time buyers.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5%

Appetite among affordable housing providers and lenders for development is uncertain, as are economic conditions relating to interest rates and housing scheme costs. This IA provides a range of scenarios relating to these variables and the scale of delivery achievable. The impact of affordable housing delivery on housing supply and economic output is uncertain and determines the scale of economic and exchequer benefits associated with development. The types of household provided with affordable housing determines the Housing Benefit and distributional implications of policy options - this is subject to local discretion.

Direct impact on business (Equivalent annual) (£m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	NA

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			England		
From what date will the policy be implemented?			01/04/2011		
Which organisation(s) will enforce the policy?			Homes & Communities Agency		
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**		**Non-traded:**
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**		**Benefits:**
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	Yes/No	Yes/No	Yes/No	Yes/No	Yes/No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[3] Statutory Equality Duties Impact Test guidance	Yes	49
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	49
Small firms Small Firms Impact Test guidance	No	49
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	50
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	50
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	50
Human rights Human Rights Impact Test guidance	No	50
Justice system Justice Impact Test guidance	No	50
Rural proofing Rural Proofing Impact Test guidance	No	50
Sustainable development Sustainable Development Impact Test guidance	No	51

[3] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment), and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	Rhetoric to reality: a report on affordable housing prospects in an age of austerity (The Smith Institute, 2010)
2	Housing People; Financing Housing, (Policy Exchange, 2010)
3	Estimating Housing Need (DCLG, November 2010)
4	Hard times, new choices (L&Q and Price Waterhouse Coopers, 2010)
5	Ends and Means: the future roles of social housing in England (John Hills, 2007)
6	Rethinking Social Housing (The Smith Institute, 2006)
7	Unlocking the Capacity from the Affordable Housing Sector (EC Harris, 2010)

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

EXECUTIVE SUMMARY

England faces substantial levels of unmet housing need. Need is a subjective concept but, according to recently published research, it is projected that around 1.9 million households currently experience some form of housing need. Forecasts suggest that affordability will also remain challenging; the average lower quartile home now costs over six times household income (and eight times in London).

Given the scale of these problems, Government intervention remains essential to meeting the housing needs and aspirations of a large section of the population.

The Government's intended policy objectives are:

- to maximise the delivery of new social housing, making the best possible use of constrained public subsidy and the existing social housing stock over the next Spending Review period, and matching delivery of new build to areas of housing need; and

- to provide an offer which is more diverse for the range of people accessing social housing, providing alternatives to traditional social rent and making the provision of social housing more flexible. The measures announced at Spending Review 2010, including Affordable Rent, will deliver up to 150,000 new affordable homes.

This Impact Assessment assesses three options in detail for government intervention to meet these objectives:

1. No policy change: continuation of the National Affordable Housing Programme in its current form.

2. Reform the delivery of affordable housing by introducing Affordable Rent, assuming that 100 per cent of available funding is used to deliver Affordable Rent units.

3. Reform the delivery of affordable housing by introducing Affordable Rent, assuming that a proportion of available funding is used to deliver affordable home ownership where this is appropriate for local circumstances and helps promote overall delivery of affordable housing. **This is the preferred option.**

It is theoretically possible to finance developments largely through across-the-board increases in rents on all or just new build social properties. However, these options are not explored in detail in this Impact Assessment. The Government has committed that existing tenants will retain their existing tenancy and rent arrangements, unless they choose to move to an Affordable Rent home. Across the board rent increases could also cause a significant impact on Housing Benefit expenditure and there would be uncertainty over the resultant increase in affordable housing supply.

The three main options are assessed assuming that the same amount of capital funding is available, spent in different ways, with outcomes compared against a baseline where no grant funding is made available for development of socially rented (at Affordable Rent or otherwise) or affordable home ownership properties beyond existing contractual commitments. Options are compared against the objectives outlined above and in light of economic appraisal results.

The analysis in this Impact Assessment demonstrates relative positions rather than forecasting actual outcomes and should therefore be understood as illustrative rather than predictive. The eventual outcome is dependent on a range of behavioural factors which cannot be modelled with any degree of certainty.

Each policy option implies different levels and types of outputs for new or converted units. Given uncertainty over some parameters a range of scenarios has been modelled for each option. In addition to the central scenario an 'upper' estimate generally provides assumptions which deliver more new homes, provides greater economic benefits per unit and features lower Exchequer costs. A 'lower' estimate takes a more pessimistic view with respect to these outcomes. Under such conditions, there are a range of mitigations which could improve delivery that have not been fully accounted for in this analysis. These include greater increases in and a different nature of property conversions in the case of Options 2 and 3, variation in costs across scale of overall delivery, and wider impacts on grant-free affordable housing delivery excluded from this IA.

We have taken account of potential reductions in rental income due to the introduction of household benefit caps as set out in the Welfare Reform Bill. This has been done by damping down the increase in financial capacity that it is assumed could be unlocked by increasing rents, especially in higher cost areas.

The Impact Assessment compares the three policy options in terms of key outcomes, namely numbers of conversions and new build affordable units and the net increase in housing supply, net costs to government and net economic benefits. The monetised costs to government are capital funding for new units and Housing Benefit costs offset by revenues generated through taxation. The monetised economic benefits are estimated via increases in the value of the land associated with its change in use, employment generated through the construction of new units and additional distributional benefits gained from allocating social housing to lower income households.

Options 2 and 3 – the variants of the Affordable Rent model – are estimated to provide significantly larger numbers of new affordable housing units (estimated at 48,000 and 56,000 in the respective central scenarios), though with a greater range across scenarios, than continuation of the National Affordable Housing Programme (estimated at 27,000 new units in the central scenario).

This suggests that housing need would be better addressed under a system of reformed social housing delivery. The estimated number of new units provided is maximised under Option 3, due to the inclusion of affordable home ownership, the addition of which also suggests greater benefits for first time buyers compared to Option 2 which does not include affordable home ownership. Incorporating such flexibility over tenure should also help secure the progress of developments and the involvement of a wide range of providers.

A summary of the net government costs and net economic benefits under the central scenario for each of the three options is presented below:

1 **Summary of appraisal results**

Options		Lower	Central	Upper
Option 1	Net Government Costs	£915m	£749m	£597m
	Net Economic Benefits	£1,168m	£1,649m	£2,166m
Option 2	Net Government Costs	£1,810m	£1,764m	£1,621m
	Net Economic Benefits	£1,759m	£2,966m	£4,696m
Option 3	Net Government Costs	£1,843m	£1,781m	£1,606m
	Net Economic Benefits	£1,932m	£3,233m	£4,880m

There is a trade off between capital and revenue expenditure, with the Affordable Rent options bringing greater costs to government through increases in Housing Benefit expenditure but this is set against a lower capital payment per new unit. The housing benefit cost of the preferred option (Option 3 central scenario) is £553m over a 30-year appraisal period.

The analysis suggests that, given a fixed capital budget and within the constraints on government expenditure over the next Spending Review period, Option 3 delivers the greatest net economic benefits, maximises the delivery of new social housing, provides the most diverse range of products for those accessing social housing and would deliver the largest reduction in housing need. On this basis, despite higher estimated costs to government in the long term, it is the preferred option.

A. BACKGROUND

England faces substantial levels of unmet housing need. Need is a subjective concept but, using recently published research[4] commissioned by the Department for Communities and Local Government (DCLG), it is projected that around 1.9 million households currently experience some form of "housing need". This total captures different needs including: families living in overcrowded conditions; concealed households; owner-occupiers facing mortgage difficulties; private tenants struggling to afford their rent and households in unsuitable accommodation (e.g. disabled people with mobility problems for whom their current accommodation is inappropriate).

There are similar data and trends in terms of affordability for would-be owner-occupiers (indeed, worsening affordability is a significant driver of housing need). Since the credit crunch, the ratio of lower quartile house prices to lower quartile incomes has fallen (with falling house prices), from 7.36 to 6.89 (England)[5]. However, this ratio is still high by historic standards. The recent fall does not represent the start of a long-term downward trend nor has it occurred as a result of increasing levels of housing supply. Affordability in terms of house prices to incomes is still stretched, particularly in London, where the ratio remains over 8:1[6].

As well as being a significant driver of housing need, affordability also represents a bar to aspiration for a significant number of households. Recent work estimates that there are approximately 1.4m existing households in the private or social sector who aspire to home ownership but cannot afford to buy a home at the lower quartile price in their region[7]. The number of first-time buyers under 30 without parental assistance has fallen by 90 per cent since 2006, with a tightening of deposit requirements exacerbating the problems caused by poor affordability[8].

Given the scale and impact of these indicators of unmet housing need and affordability, Government intervention remains essential to meeting the housing needs and aspirations of a large section of the population.

While recognising the need to address the problems of housing need and affordability, tackling Britain's record deficit is the Coalition Government's top priority - the consequences of not acting could be serious. The scale of the deficit has required tough choices to be made about how taxpayers' money is allocated.

In order to tackle the budget deficit all government departments are being required to work within a very tight fiscal settlement. Allocation decisions have followed a zero-based review of capital spending plans, which involved analysing and scrutinising the projects and programmes across Government.

Government intervenes in two key ways to tackle problems of housing need and affordability. Firstly, through demand-side subsidy, in the form of Housing Benefit and Support for Mortgage Interest, to help people to meet their housing costs. Secondly, through supply-side subsidy to support the construction of new affordable homes.

Case for reform

Historically this supply-side subsidy has been made through the National Affordable Housing Programme (NAHP). The NAHP had been successful in delivering new affordable housing, but the model involved a high capital cost to Government. Over the period 2000-01 to 2009-10

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[4] *Estimating Housing Need* (DCLG, November 2010) http://www.communities.gov.uk/publications/housing/estimatinghousingneed
[5] DCLG Live Table 575 http://www.communities.gov.uk/documents/housing/xls/table575.xls Figures for Q3 2007 and 2010
[6] DCLG Live Table 576 http://www.communities.gov.uk/documents/housing/xls/152924.xls
[7] http://www.communities.gov.uk/housing/homeownership/
[8] DCLG calculations based on CML (2011) *Problems for first-time buyers*, News & Views, Issue Number 3, 15 Feb 2011

some £17bn was spent on the provision of new affordable housing through the NAHP. 431,400 new affordable homes were provided over this period.

Given the current constrained fiscal position, the historical levels of grant funding for social housing were widely judged to be unsustainable, with several commentators suggesting alternative funding methods. *Housing People; Financing Housing* by Policy Exchange asserted that without new sources of finance and continued reliance on government grant housing associations could stagnate or shrink[9]. In addition, the 2010 Smith Institute paper *Rhetoric to reality: a report on affordable housing prospects in an age of austerity* argued that without new solutions for affordable housing and joint action by government and housing associations to develop a new funding model, the provision of affordable housing would reduce progressively over the medium term[10].

The Government has committed to continued investment in new affordable housing with approximately £4.5bn over this Spending Review period, but that funding needs to go further[11]. To enable this, the Government is introducing new flexibilities for providers on the use of existing assets and a new offer on rents. The introduction of higher rents to cross-subsidise future development and greater flexibility to manage housing portfolios has been advocated in a number of independent reports in recent months[12,13].

There are other concerns with the existing social housing system. There are now 1.8 million households on waiting lists[14] many of whom have no realistic chance of being allocated a home. Levels of worklessness in the sector are very high and mobility is relatively low[15,16].

The 2007 review of social housing by John Hills explored the future role of social housing and emphasised the need to consider a “more varied menu” for both prospective and existing tenants, including the possibility of regular review every few years to establish whether someone’s circumstances had changed and whether a different solution would now be more appropriate. Some of the ideas in the Hills report are based on the notion of time limited support e.g. “entitlement to fixed support (such as through vouchers) for a certain period, such as one to five years”[17]. In addition, the 2006 Smith Institute report *Rethinking Social Housing* recommended increasing flexibility of tenure and challenged the assumption that a tenancy for life would be appropriate in all cases[18].

Further independent recognition of the need to develop alternative funding models given the pressures on public finances comes from the Scottish Government's housing strategy *Homes Fit for the 21st Century: The Scottish Government's Strategy and Action Plan for Housing in the Next Decade; 2011-2020*[19]. This sets out a number of innovative funding methods to deliver new affordable housing in ways which lever in the maximum possible amount of funding from elsewhere, including through increased borrowing capacity and cross-subsidy from providers' own resources.

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[9] *Housing People; Financing Housing*, (Policy Exchange, 2010)

[10] *Rhetoric to reality: a report on affordable housing prospects in an age of austerit*y (The Smith Institute, 2010)

[11] Full details of the investments that may be funded within this budget are provided in *2011-15 Affordable Homes Programme – Framework* (DCLG/HCA 2011). This IA considers only options for spending the £1.8bn allocated to Affordable Rent and affordable home ownership, as outlined in Annex 2 of that document.

[12] *Hard times, new choices* (L&Q and Price Waterhouse Coopers, 2010)

[13] *Unlocking the Capacity from the Affordable Housing Sector* (EC Harris, 2010)

[14] DCLG Live table 600: http://www.communities.gov.uk/documents/housing/xls/1783262.xls

[15] In 2008-09 only 49 per cent of social tenants of working age were in work compared to 71 per cent in 1981. Office for National Statistics, Labour Force Survey 1981; DCLG, English Housing Survey 2008-09

[16] According to the English Housing Survey (2008-09), just 8 per cent of social tenants had moved in the last year: http://www.communities.gov.uk/documents/statistics/xls/1750095.xls

[17] *Ends and Means: the future roles of social housing in England* (John Hills, 2007)

[18] *Rethinking Social Housing* (The Smith Institute, 2006)

[19] Scottish Government 2011, http://www.scotland.gov.uk/Publications/2011/02/03132933/0

To address the above problems, the Government has launched a wider programme of reform of social housing. The Government is committed to making better use of existing social housing, targeting support where it is most needed. It is taking action to introduce a range of radical reforms and create a more responsive and flexible system that will allow local authorities and social landlords to have more control. A ‘one size fits all’ model is not considered the most appropriate solution and a guarantee of lifetime tenancy at social rent does not necessarily take account of changing circumstances.

The Government’s consultation document *Local decisions: a fairer future for social housing* and the Localism Bill, introduced on 13 December 2010, set out proposals for radical reforms for social housing[20]. The Localism Bill, when enacted, will create a new flexible tenancy for local authority landlords with a minimum fixed term of two years, which will be in addition to, rather than replacing, secure and introductory tenancies. We are proposing to extend similar freedoms to all social landlords through changes to regulation. The rights of existing secure and assured tenants will be protected.

[20] http://www.communities.gov.uk/localgovernment/decentralisation/localismbill/

B. OBJECTIVES

The Government's ambition is to reform affordable housing provision to enable it to better address inequity and the market failures associated with housing need and poor housing affordability. To this end the specific objectives of the Affordable Homes Programme reforms are:

- to maximise the delivery of new social housing, making the best possible use of constrained public subsidy and the existing social housing stock, over the next Spending Review period; and
- to provide an offer which is more diverse for the range of people accessing social housing, providing alternatives to traditional social rent and making the provision of social housing more flexible.

C. POLICY OPTIONS

Tackling Britain's record deficit is the Coalition Government's top priority. The scale of the deficit has required tough choices about how taxpayers' money is allocated.

The Spending Review sets out how the Coalition Government will carry out Britain's deficit reduction plan. The Government considers this an urgent priority to secure economic stability, at a time of continuing uncertainty in the global economy, and put Britain's public services and welfare system on a sustainable long-term footing. International bodies such as the International Monetary Fund and Organisation for Economic Cooperation and Development have noted that reducing the deficit is a necessary precondition for sustained economic growth. Failure to take action now would put the recovery at risk and place an unfair burden on future generations. It would also risk pushing up mortgage rates and making housing less affordable.

In order to tackle the budget deficit all government departments are being required to work within a very tight fiscal settlement. Allocation decisions have followed a zero-based review of capital spending plans, which involved analysing and scrutinising the projects and programmes across Government.

The National Affordable Housing Programme had been successful in delivering new affordable housing, but the model involved a high capital cost to Government and was perceived to be largely governed by top-down direction. As part of the zero-based review of capital spending, alternative approaches have been considered to reform the delivery of new affordable housing:

1. Continuation of the National Affordable Housing Programme - continuing the National Affordable Housing Programme without reform, providing £1,803.5m of funding on top of the existing contractual commitments over this Spending Review period (2011-15);

2. Introduction of Affordable Rent – introduction of Affordable Rent assuming 100 per cent Affordable Rent delivery, providing £1,803.5bn of funding over this Spending Review period;

3. Introduction of Affordable Rent with affordable home ownership (previously known as low cost home ownership) – introduction of Affordable Rent including an element of affordable home ownership (previously known as low cost home ownership) delivery, providing £1,803.5bn of funding over this Spending Review period;

4. Allowing **modest increases in target rents** across the board;

5. Allowing **modest increases in target rents,** but limiting these increases to **new build properties only**.

1. CONTINUATION OF THE NATIONAL AFFORDABLE HOUSING PROGRAMME

The existing arrangements for the delivery of new affordable housing are via the National Affordable Housing Programme (NAHP) which over the past ten years has invested over £17bn. The NAHP has supported provision of over 240,000 new social homes for rent and over 129,000 homes for Intermediate housing between 2000-01 to 2009-10.

Policy Option 1 models the impact of using the (approximately £2bn) capital budget for delivery of new affordable homes and spending it under the arrangements of the National Affordable Housing Programme. This would create some construction starts that are not completed (or fully funded) within the next Spending Review period, 2011/12 to 2014/15, due to payments being made upon both start and completion on site.

2. INTRODUCTION OF AFFORDABLE RENT (ASSUMING 100 PER CENT AFFORDABLE RENT PROVISION)

Affordable Rent would offer providers (predominantly housing associations) the flexibility to convert vacant social rent properties to Affordable Rent at re-let, at a rent level of up to 80 per cent of market rent (including service charges). Providers would be able to convert vacant properties to Affordable Rent where they have reached a supply agreement with the Home and Communities Agency about how additional rental income will be reinvested in the supply of new affordable housing. Government funding would be paid on completion of new homes.

Agreements could also involve approval in principle for future asset management plans that include social housing disposals, where funds raised are reinvested, subject to the need for statutory consent and consultation with the relevant local authorities. The Tenant Services Authority would be engaged in the process to ensure that providers can continue to meet its regulatory standards, including on viability.

It is envisaged that Affordable Rent properties would be allocated in the same way that social rent properties are now. The existing regulatory obligation on providers to co-operate with local authorities' strategic housing function on the allocation of social rent properties will also apply to Affordable Rent. Similarly it is envisaged that existing lettings arrangements operated by local authorities and housing associations would continue to apply and that Affordable Rent properties will – where appropriate – be made available through choice-based lettings.

By allowing landlords the flexibility to charge higher rents on new properties and by converting some existing properties which fall vacant, the Affordable Rent model would enable additional borrowing capacity to be generated for reinvestment in affordable housing. **This allows more units to be delivered for the same level of capital subsidy from Government than under the existing National Affordable Housing Programme.**

3. INTRODUCTION OF AFFORDABLE RENT (ASSUMING AN ELEMENT OF AFFORDABLE HOME OWNERSHIP)

Policy Option 3 is a variant of Policy Option 2, allowing some social properties to be converted to affordable home ownership, and a proportion of new units to be delivered as such. The extent to which these products are offered would be determined by local needs and subject to the approval of overall offers by the Homes and Communities Agency which would take account of the value for money provided by the affordable home ownership homes. Government funding would be paid on completion of new homes.

The inclusion of affordable home ownership within the investment agreements reached between the Homes and Communities Agency and registered providers could bring additional benefits, including helping households - including those without access to funds - to acquire assets; providing additional options for existing social tenants who have improved their circumstances and no longer need such high levels of state support; and helping to address housing need.

The ability to include an element of affordable home ownership within the package proposals submitted by delivery partners could also help to ensure that the Affordable Rent model will be viable in areas where there is insufficient difference between market rents and social rents to service a substantial increase in debt.

4. MODEST INCREASES IN TARGET RENTS ACROSS THE SOCIAL HOUSING SECTOR

Conceptually it should be possible to finance development largely through rental income. An across the board increase in the rents for existing social housing tenants could raise significant amounts of money and enable additional borrowing capacity, which could in turn be used to finance new development. However, this option is likely to result in more certain increases in Housing Benefit costs and there is some risk that some of this income would not be converted into development potential in the next Spending Review period and would therefore not translate into supply of new affordable housing. Ministers have also been clear that the rights of existing secure and assured tenants will be protected.

Rents in the social sector are calculated according to a "formula rent". Assuming an increase of 1.5 per cent (over the increase that would otherwise have been delivered by this formula for two years from 2012/13) would only modestly improve the long run financial case for development, increasing the Net Present Value of the income stream for a new social rent property by around £3,000, roughly 2 per cent of average scheme costs. As such, government may have been unable to reduce grant rates enough to increase the number of units funded significantly while still providing sufficient incentive for the sector to use its financial capacity.

However, such a rent increase would have an impact on Housing Benefit, from the current stock, of an estimated £370m over the Spending Review period. While this rent increase would generate a substantial amount of additional rental income, possibly raising the amount of debt that could be serviced to around £5bn by 2014/15, there would be no guarantee that all of this funding would be put towards new supply. Many registered providers (mainly housing associations), particularly those which have recently taken local authority stock transfers, have insufficient cash or capacity to undertake development. Others may instead choose to use some of the income for other purposes such as renovating existing stock, expanding other areas of the business, or building reserves.

Given the far more certain and detrimental impact on public finances represented by the increase in Housing Benefit costs, and the current fiscal context, this option would therefore represent a significant risk and would have conflicted with the Government's commitment to protect the rights of existing tenants.

This Option was therefore not modelled in further detail for this IA.

5. MODEST INCREASES IN TARGET RENTS, APPLIED ONLY TO NEW BUILD PROPERTIES

A more targeted increase in formula rents was also considered – for example limited to new build social housing only. This would have a reduced impact on Housing Benefit in comparison to raising rents across the social housing sector. However even with a higher rent increase, for instance a 3 per cent increase over formula for two years from 2012/13, the Net Present Value of the income stream from a new social rent property would increase by around £6,000, roughly 4 per cent of average scheme costs. While the Homes and Communities Agency could reduce grant rates on new properties correspondingly, it would result in less net additional capacity for the sector as a whole than Option 4. Delivering substantially more housing under this scenario would require a significant increase in cross-subsidy, while providing no extra resources to do so.

This Option was therefore not pursued and is not assessed in detail in this IA.

This Impact Assessment assesses Options 1, 2 and 3 above in detail.

D. COST BENEFIT ANALYSIS

1. Methodology and summary of potential impacts

Introduction

This section explains the methodology used in this Impact Assessment to assess the potential impacts of affordable housing funding which form the basis for comparison across policy options. Options are assessed assuming the same amount of grant funding is available, spent in different ways with outcomes compared against a baseline with no grant funding for development of socially rented (at Affordable rents or otherwise) or affordable home ownership properties beyond existing contractual commitments. Options are compared against the objectives outlined above and in light of economic appraisal results.

The overall approach is to assess the potential impacts of different scenarios under a consistent modelling methodology and set of assumptions. It demonstrates relative positions rather than forecasting actual outcomes and should therefore be understood as illustrative rather than predictive. The eventual outcome is dependent on a range of behavioural factors which cannot be modelled with any degree of certainty. For example, there are clearly differences between having the theoretical financial capacity to undertake a development, the organisational appetite to undertake it, and the physical availability of a suitable site at a suitable time, and only the first of these can be modelled. For any of the Options considered, delivery of new supply is also dependent on the outcomes of the Homes and Communities Agency funding decisions.

A key outcome is that each policy option implies different levels and types of outputs, in terms of the number of units delivered or converted to new tenures. Given uncertainty over some parameters a range of scenarios has been modelled for each option. This Impact Assessment considers, and where possible, quantifies, outcomes with respect to a range of variables including: housing need; overall housing supply; employment and output effects; distributional consequences of providing sub-market rents; government financial expenditure, including on Housing Benefit; home ownership and housing aspirations; work incentives; costs and benefits to registered providers (principally housing associations).

Modelling of delivery and economic impacts is highly uncertain and it is difficult to predict the types, costs and eventual outcomes of contracts that will be agreed over the course of negotiations for the four-year Affordable Homes Programme. There is clearly a difference between financial capacity and appetite for development. Results should therefore be treated as illustrative scenarios rather than definitive forecasts of outcomes. The Impact Assessment does not attempt to assess the long term impacts of a permanent change to this new delivery model, rather the marginal effects arising from the programme considered. The following outlines the approach taken towards developing output scenarios and assessing options with respect to the impacts listed above.

Delivery modelling approaches

Social housing providers have four main sources of financing for new development: borrowing, supported by ongoing revenues from the new build stock or elsewhere in the business; capital contributions, either from part-sale of the new stock or capital receipts elsewhere in the business; planning gain contribution under Section 106, reducing the capital cost; and government funding. Financing sourced from elsewhere in the business is referred to in this assessment as cross-subsidy.

Guidelines issued by the regulator (currently the Tenant Services Authority), as directed by the Housing Minister, keep social rents below those which the private market would offer. Providers have less control over the tenants they accommodate, must adhere to specific standards for property development and tenancy management and generally offer a wide range of other services which provide social benefits. The associated costs mean that government subsidy is usually required to make developments viable for the provider. The subsidy also effectively acts as a deposit for new finance, allowing providers to borrow at reasonable loan-to-value levels. This results in lower sector gearing than would be the case without government funding, lower perceived risk and hence lower borrowing rates.

While Local Authorities and other organisations will be able to bid for grant under the Affordable Homes Programme, this Impact Assessment only considers potential delivery from housing associations, as they are expected to contribute the majority of associated development. Scenarios for delivery of new grant-funded affordable homes are tested for consistency with two sets of constraints:

1. To maintain long term viability, investments in housing must generate sufficient return on the provider's investment. Grant payments must ensure that the outlay is financially sustainable and attractive for the organisation, though the returns required are generally lower than for the private sector given charitable objectives and not-for-profit structure.
2. Even if an investment product is judged to be worthwhile in the long run by a provider, the total number of properties they can develop is determined by the availability of cashflow and assets to satisfy conditions of lending (gearing).

The following sections outline the approaches taken to estimate potential output under each policy option. Detailed assumptions are provided in section 2.

MODELLING THE NET PRESENT VALUE OF INVESTMENT

A 30 year appraisal method is used to judge the financial worth of investments to housing associations under each option. This compares rent income with development and operating costs in Net Present Value (NPV) terms, separately for different property sizes and for each region.

OPTION 1 MODELLING APPROACH

Including recent National Affordable Housing Programme grant rates in the NPV model gives some indication of the extent to which provider's currently 'cross subsidise' affordable housing development[21]. The continuation of the NAHP is modelled by assuming this level of cross subsidy is maintained by providers, and updating cost, rents and discounting assumptions in the appraisal model to provide an estimate of the new levels of grant required for the investment to break even. Affordable home ownership grant rates as a proportion of total scheme cost are assumed to remain unchanged from the 2008-2011 National Affordable Housing Programme.

[21] The amount by which grant rates fail to fully offset the net costs to providers in NPV terms is taken to be equal to recent levels of cross subsidy per unit. Such figures are not verifiable using scheme data and are dependant upon appraisal assumptions, for instance on discount rates.

In contrast to the 'payment upon completion' approach of Options 2 and 3, this model features some delay between payment for starts on site and for completions, typically with half of the allocated grant paid at each stage. As a result, some part-funded housing completions would occur outside of the Spending Review period. Given that they require additional funding excluded from the appraisal of the other options, assumed delivery of such units is therefore reduced proportionately, by a half.

OPTION 2 MODELLING APPROACH

Here, scenarios for conversion to and delivery of Affordable Rent properties are tested for viability using the same 30 year appraisal method described above; the higher income levels on newly built properties and converted units are assumed to offset grant requirements. This assumes that all rented units are provided at 80 per cent of market rents, with adjustments made to account for changes in benefits policies (see section 2). In practice, in exceptional cases where providers are permitted to offer lower rents than those assumed here, it is likely that more conversions would be required to fund development.

Scenarios are also tested using actual housing association data to assess the impact on provider businesses and the level of development which might be achieved within the constraints of both available grant and other funding streams, on a regional basis.

This analysis builds a base position for each provider, informed by annual accounts and stock data supplied to the Tenant Services Authority and current allocations data from the Homes and Communities Agency. Each provider's base position is then overlaid with an Affordable Rent conversion and build programme which assumes that providers will build in proportion to their existing regional stock. The build cost and grant levels of this overlay are taken from the NPV work described above. Constraints are applied on the amount of cash which each provider can use to service debt and the level of re-let conversion to arrive at a global estimate of regional delivery potential.

OPTION 3 MODELLING APPROACH

The approach is similar to that for Option 2. While in practice a greater range of products may be included in bids under the Affordable Homes Programme in some circumstances, for the purpose of modelling it is assumed for simplicity that all conversions under this Option are to either Affordable Rent or affordable home ownership in the form of shared ownership. Sales receipts from converted properties are assumed to contribute to funding requirements for new units. Subsequent share purchases by tenants of both new and converted shared ownership properties are assumed to further contribute to the NPV assessment of development contracts in determining funding requirements.

IMPACTS ON SUPPLY OF THE RECYCLED CAPITAL GRANT FUND

If and when grant-funded homes are sold (or part-sold, and also when further shares are later sold, in the case of affordable home ownership products), there is system in place to allow registered providers to recycle Government grant through the Recycled Capital Grant Fund for those providers who operate such a fund. This means that the cash value of grant is placed in a fund and can be used for projects that would be eligible for social housing funding (principally investment in new supply but with some scope for other uses such as major repairs, refurbishment and enabling flexible tenure). Housing associations have three years to spend the money in this way; if they fail to do so they repay the grant to the Homes and Communities Agency[22]. Under existing arrangements, providers of properties on affordable home ownership terms are under obligations to 'recycle' the grant they have received from Government with

[22] http://cfg.homesandcommunities.co.uk/recycled%20capital%20grant%20fund%20administration.htm

respect to those properties upon subsequent sales[23]. When a further share (or the full remaining equity) is purchased, the provider must allocate an amount of funding equal to a proportion of the grant they originally received for that unit to eligible uses (principally funding additional new supply within three years) or pay the amount back to the Homes and Communities Agency. The proportion of landlord-held equity that is sold determines the proportion of the original grant amount that must be used. This Impact Assessment assumes that such grant recycling is used for further affordable housing development at contemporaneous scheme costs, with no additional funding from elsewhere assumed. The resulting properties are incorporated in the economic appraisal.

Assessing the impacts of social housing provision

The following summarises the potential effects of social housing considered in this IA, and describes the methodology of appraisal in each case.

HOUSING NEED

As outlined above, a very large number of households in England are in unmet housing need. This provides a strong rationale for intervention on the grounds of equity. However, where housing need is associated with negative externalities, wider social costs and burdens on public expenditure, reducing it will also provide benefits on the grounds of economic efficiency. For instance, research suggests that overcrowding can cause damage to health, particularly for children who may also suffer worse educational outcomes[24].

Around 90 per cent of new social lettings are made to households who, broadly speaking, fall within a Reasonable Preference (RP) category[25], and many of these households would be expected to be in some form of housing need, as defined by recent DCLG research[26]. This research has produced a forecasting model for housing need. Results from alternative scenarios of net additions suggest that additional private supply reduces housing need, partly through its effects on general affordability. An increase in social supply reduces the numbers in housing need by three times as much as a rise in private supply of the same amount, with these housing services better targeted at those in need. Running alternative supply scenarios suggests that within a medium term timescale, for every 100 social rented homes supplied, need would fall by 63 households in the medium term. The research also suggested that there is a good case for a balance of provision including intermediate tenures such as affordable home ownership in order to reduce need.

This suggests that provision of affordable housing can improve social outcomes, even where it displaces private supply of homes. Whilst the evidence presented here most closely applies to the previous social housing system, this Impact Assessment generally assesses options against housing need in terms of maximising the number of social units that can be delivered, with rented accommodation expected to have a stronger impact on need in general.

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[23] http://cfg.homesandcommunities.co.uk/recycled%20capital%20grant%20fund%20administration.htm

[24] See *Household Formation in Scotland: What does it mean for Housing Policy?* (Scottish Government, 2010) http://www.scotland.gov.uk/Publications/2010/07/13084549/1, *The Dynamics of Bad Housing* (NatCen, 2008) http://www.natcen.ac.uk/study/the-dynamics-of-bad-housing-, *The impact of overcrowding on health and education: a review of the evidence and literature* (ODPM, 2004) http://www.communities.gov.uk/documents/housing/pdf/138631.pdf, *Crowded house, Cramped living in England's housing* (Shelter, 2004) http://england.shelter.org.uk/__data/assets/pdf_file/0003/39234/7410.pdf

[25] Unpublished DCLG analysis of CORE (2008-09)

[26] *Estimating Housing Need* (DCLG, November 2010)

DISTRIBUTIONAL BENEFITS OF SOCIAL HOUSING

While subject to local discretion and without continual means-testing, social housing tends to be targeted towards households on relatively low incomes. As explained in HM Treasury's Green Book[27], the impact of a policy on an individual's well-being will vary according to his or her income; the rationale being that an extra pound will give more benefit to a person who is deprived than to someone who is well off. In economics, this concept is known as the 'diminishing marginal utility of additional consumption'. Distributional analysis allows us to account for the economic benefits of making UK household consumption more evenly distributed. The following table shows the position of current social tenants in the national income scale, using equivalised income measures which take into account household size on the assumption that larger households need greater incomes to achieve a given standard of living.

Table 1: Position of current social tenants in national income distribution[28]

	Percentage of social rented sector households									
Equivalised income decile:	**1st**	**2nd**	**3rd**	**4th**	**5th**	**6th**	**7th**	**8th**	**9th**	**10th**
London (Before Housing Cost)	12	17	17	15	11	9	9	5	3	1
Rest of England (Before Housing Costs)	13	20	19	17	11	8	6	4	1	0
London (After Housing Costs)	22	23	15	11	7	7	7	4	3	1
Rest of England (After Housing Costs)	17	21	20	14	10	7	5	3	1	0

Source: Family Resources Survey (2006/7 to 2008/9)

The Affordable Rent policy will have two sets of impacts on the consumption of low-income tenants, compared to provision of social housing under the previous NAHP:

1. For those who are placed in properties on Affordable Rent who would have otherwise received a Social Rent property, either new or previously converted from social rent, the rent paid will be higher. Those in receipt of Housing Benefit may see little or no impact on income or consumption, as benefit payments may offset this.
2. For those allocated an Affordable Rent property who would not otherwise had access to social housing, there is a benefit which can be associated with the value of 'economic

[27] See Annex 5 in *The Green Book* (HM Treasury, 2003) http://www.hm-treasury.gov.uk/data_greenbook_index.htm

[28] Note: These statistics are based on Households Below Average Income data sourced from the 2008/09 Family Resources Survey. This uses disposable household income, adjusted using modified OECD equivalisation factors for household size and composition, as an income measure as a proxy for standard of living. For Before Housing Costs, housing costs (such as rent, water rates, mortgage interest payments, buildings insurance payments and ground rent and service charges) are not deducted from income, while for After Housing Costs they are.

subsidy' - the difference between the market rent and affordable/social rent of the property, which may be linked to its quality and value to the tenant. This benefit might be reflected in obtaining a higher level of housing consumption than previously and/or also having more income left to spend on other goods after housing costs. Those who have all of their rent met by Housing Benefit will only see an improvement in consumption if they are able to access a property in the social sector which is better suited to their needs.

Without a direct measure of the benefits social tenants obtain from subsidised housing, through gaining access to housing without paying the full market price, this Impact Assessment analysis takes estimated market rent as a proxy for a consumer's valuation of housing. Accounting for changes in Housing Benefit, estimated using methods outlined below, the net impact on consumption for social tenants under each policy option is estimated using rent assumptions and delivery scenarios, with prospective rent increases reducing tenant consumption and provision of economic subsidy improving it. Increases in economic subsidy to tenants in need are assumed to improve the distribution of income as they are paid for by others on generally higher incomes, for instance through taxes. Using different distributional weights for individuals on different income levels, the potential net economic benefits of such impacts are estimated in line with Green Book guidance. This analysis is highly dependant on assumptions of the characteristics of future social tenants due to the interactions with the Housing Benefit system. Given the flexible, localist nature of the Affordable Rent model, results are therefore subject to significant uncertainty and should be regarded as illustrative not predictive. They do not take into account any further distributional benefits for affordable home ownership tenants.

Such impacts overlap with the concepts of housing need described above. For example, an increase in housing consumption for a family who can afford to move into a larger home is likely to come with a reduction in overcrowding. However, the inferred changes in private consumption will not account for the wider social benefits of reducing need or the specific external costs associated with poor housing.

THE ECONOMIC BENEFITS OF INCREASING HOUSING SUPPLY

The Barker Review of Housing Supply[29] found that housing supply had in the years considered failed to meet demand, and that increasing supply could improve UK economic wellbeing. Other research further demonstrates the effect of restricted supply on affordability[30]. Publicly-funded housing can play an important role in supporting overall supply; particularly following the onset of recessions[31]. Housing association and local authority-provided housing represented 22 per cent of housing completions in 2009/10, compared to an average of 12 per cent over the preceding decade[32].

The 'additionality' of affordable housing is the proportion of new affordable homes delivered which translate into an additional home and not a displacement of private supply. Additionality will vary across location and point in time, increasing for example in periods of subdued house building activity as exhibited at present[33]. Affordable housing funding is most likely to increase supply where it develops infill sites; improves site viability, with indirect impacts on private supply; brings supply forward in the face of funding delays; there are planning restrictions and local priorities which favour social housing; or where financial market problems restrict the

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[29] *Delivery stability: securing our future housing needs* (HM Treasury, 2004) http://www.barkerreview.org.uk/

[30] *The impact of restricting housing supply on house prices and affordability* (DCLG, 2004) http://www.communities.gov.uk/documents/housing/pdf/1767157.pdf

[31] *The Role of Housing in the Economy* , p.8 (HCA, 2010) http://hcaadmin.com/public/documents/Housing_Investment_and_the_Economy.pdf

[32] DCLG Live Table 1772176 http://www.communities.gov.uk/housing/housingresearch/housingstatistics/livetables/

[33] *Additionality Guide* (English Partnerships, 2004) http://www.urcs-online.co.uk/webmaster3/files/urcs/website/backgroundDocuments/Document/Additionality%20Guide.pdf

availability of credit. Statistical evidence suggests a positive relationship between social housing supply and private completions in recent years at local level[34].

Conversion of land to residential use can increase its market value. Land values are one component of house prices, which provide a market valuation of what consumers are willing to pay, either as owner occupiers or renters, for the use of housing. As part of the house price or rent they pay goes towards covering land costs (including the economic rent that landowners receive), land value uplifts represent at least part of the economic benefits derived from housing. They are also additional to payments made with respect to the construction of housing. Some of this increase in value may be captured by central and local Government through developer contributions enforced by the land use planning system, and some will accrue to landowners. For this IA, average potential land value uplifts are estimated using Valuation Office Agency data which demonstrates differences between values of land used for different purposes – comparing residential land values with those of industrial or agricultural use and adjusting for the external environmental benefits of leaving land undeveloped. These are taken as a proxy for the economic benefits of providing an additional home in each region, assuming the private benefits of affordable housing are comparable to those captured by aggregate market data. Relevant assumptions are described in Section 2.

THE LABOUR MARKET BENEFITS OF HOUSING SUPPLY

There are wider benefits of housing supply that will not be fully captured in such valuations. It can prevent the housing market adding friction to the labour market by enabling people to move jobs and match the supply of skills to demand, improving productivity and widening employment opportunities. One in five businesses regard house prices as a constraint to business expansion in their area, rising to 44 per cent of London firms[35].

Despite the positive impact housing supply has on labour mobility in general; there is evidence to suggest that tenants in the social rented sector exhibit low propensities to move[36]. This is driven by a number of factors such as reluctance to give up sub-market rents and lifetime tenancies. However, evidence from DWP research found that very few respondents reported that the difficulty of moving house within the sector acted as a barrier to securing work [37].

As detailed in the Impact Assessment for proposals contained in the Localism Bill[38], various reforms being undertaken in parallel to this could help alleviate issues about mobility in the social sector, while a move to Affordable Rents may also influence the incentives for tenants to move. As such, and given the mixed evidence presented, this Impact Assessment does not draw firm conclusions on the impact for tenant mobility of alternative policy options.

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[34] *Planning and Housing Supply in Two-speed Britain: Modelling Local Market Outcomes* (Bramley and Leishman, Urban Studies, Vol. 42, No. 12 2213-2244, 2005), *The Nature and Implications of a Model of Housing Development Costs in England* (Bramley and Leishman, presented at the ENHR Housing Economics Workshop Seminar in Copenhagen, Feb 2006). Further work using more recent (1997-2007) data also suggested this relationship, undertaken within the study *A Feasibility Study of Sub-Regional and Cross-Regional Models of the Housing Market and Affordability* (NHPAU, 2010) and in ongoing work by Bramley for Gloucestershire County Council.

[35] *Housing investment: Part 2 The role of housing in building local economic growth*, (Shelter, 2011)

[36] See *The Role of Housing in the Economy* (Regeneris Consulting and Oxford Economics, 2010), *Ends and means: the future roles of social housing in England* (John Hills, 2007) and *Housing and the Economy: Policies for Renovation* (OECD, 2011).

[37] *Social housing and worklessness: Key policy messages* (DWP, 2008) http://research.dwp.gov.uk/asd/asd5/rports2007-2008/rrep482.pdf

[38] *Impact Assessment for Local Decisions: A Fairer Future for Social Housing* (DCLG, 2011).

THE ECONOMIC IMPACTS OF HOUSING CONSTRUCTION

As outlined above, affordable housing funding can play an important role in supporting housing supply. However, the benefits proxied by land value uplifts exclude the economic output generated through construction of additional homes. Construction has traditionally played an important role in the UK macroeconomy. A recent study by Oxford Economics and Regeneris Consulting found that housing-related Gross Value Added, including maintenance and repairs, amounted to around 2-2.5 per cent of total UK Gross Value Added over the last 25 years, and that the fall in residential investment between 2007 and 2009 contributed 1.1 per cent to the overall fall in GDP of 4.1 per cent over that time[39]. The study further notes that residential investment did not contribute strongly to the boom that preceded 2007.

This, and the evidence provided by the Barker Review, suggests that the UK has not suffered from an over-supply of housing in recent decades. Housing construction therefore provides a sector in which to support investment demand and economic growth without creating wasteful output or wage inflation. Furthermore, with a low import propensity, the sector's input demands are relatively intensive, generating strong multiplier effects which further enhance the output effects of housing investment.

In times of strong economic growth and low levels of latent capacity, it can be expected that policies which increase output and employment in one sector of the economy may lead to displacements of activity elsewhere. It is likely that although unemployment is projected by the Office of Budget Responsibility to fall to 5.8 per cent by quarter one of 2016[40], in the short term there will be spare capacity in the economy in general and the construction sector in particular. This Impact Assessment estimates the benefits of new affordable supply, where it is additional, on housing construction in terms of jobs created and increases in Gross Value Added. Full assumptions are provided in Section 2.

GOVERNMENT FINANCIAL IMPACTS

The total amount of funding provided by central government to Affordable Housing providers is held fixed across each policy option in this IA. However, further impacts on the exchequer have been identified; the approach taken to estimating these is as follows.

HOUSING BENEFIT IMPACTS

Placing a household in the social sector will lead to a government saving if they would have otherwise been on Housing Benefit in the usually more expensive private rented sector or, in the shorter term, Temporary Accommodation. The amount of Housing Benefit paid to tenants in either sector depends upon their rent. The Affordable Rent model changes social housing supply's interaction with Housing Benefit in several ways:

- For those units which have been converted to higher rents, tenants entering these properties who are in receipt of Housing Benefit will incur a greater cost to government compared to a counterfactual where they would otherwise have been provided with a social rent unit.
- For those units which have been converted to affordable home ownership or otherwise removed from the social stock, the loss of a potentially Housing Benefit-saving sub-market unit will incur a government cost.
- For those units newly supplied, the Housing Benefit savings at higher rents will be less than if a social rented unit had been provided.

[39] *The Role of Housing in the Economy* , p.8 (HCA, 2010) http://hcaadmin.com/public/documents/Housing_Investment_and_the_Economy.pdf
[40] Source: http://budgetresponsibility.independent.gov.uk/d/economy_supplementary_tables_291110.xls

- Enabling more units to be supplied for a given budget will, all else being equal, create more opportunities to divert households from more expensive tenures.

Units supplied or converted to new flexible tenancies may see a higher turnover of stock to tenants who are in greater genuine need for social housing, and tenants of different income levels may be allocated to properties depending on whether they are at social or affordable rents. Both would influence the proportion of rent covered by Housing Benefit for the properties considered in this IA. In these respects the behaviour of landlords and local authorities will be influential and is uncertain; the illustrative modelling approach does not take account of a change in behaviour or its interaction with Housing Benefit take-up for Affordable Rent properties.

TAX IMPLICATIONS OF ADDITIONAL EMPLOYMENT

The creation of jobs through the expansion of housing supply will create and support income for employees who have not been displaced from other employment. These additional workers will create revenue streams returning to the exchequer in the forms of income tax, employee national insurance contributions and net Job Seekers Allowance foregone. Using the estimates of job creation described above, the tax implications of this are estimated, assuming each job is for the duration of one year. These results exclude impacts on non-Job Seekers Allowance out of work benefits and employer National Insurance Contributions and so will understate the net impacts on tax revenues of building additional homes. This can be used to offset other costs to the Exchequer.

COUNCIL TAX-RELATED IMPACTS

Increases in housing supply raise the number of households required to pay council tax, improving government receipts overall. To some extent, this is offset by Council Tax Benefit payments. The New Homes Bonus is designed to incentivise local authorities to increase housing supply. It is paid as an unringfenced grant, equal to the average council tax on each additional property and for properties brought back into use, for the following six years. There is an enhancement for affordable homes, which will take the form of an increase of a flat rate £350 per annum for each additional affordable home. The operation of the New Homes Bonus and the Formula Grant system of local government finance mean that, in practice, increases in council tax receipts caused by additional housing supply in a particular area may be redistributed to other parts of the country. This Impact Assessment estimates the total effect on tax receipts net of increases in benefit payments, using assumptions outlined in Section 2.

IMPROVING PROSPECTS FOR HOME OWNERSHIP

Affordable home ownership products help households acquire assets, particularly those without access to funds. These provide benefits for individual households beyond those captured in estimates of housing need implications.

Under the new programme, social tenants will continue to have priority for affordable home ownership and targeting will be improved. Additional affordable home ownership units may therefore also help provide better options for existing social tenants who have improved their circumstances to the point at which they require a lower level of government support and may be approaching the end of a flexible social tenancy, would like to enter home ownership, but are unable to save for a deposit to achieve home ownership in the private market and raise a mortgage for purchase of the full equity of a property. This would allow their current dwelling to be used to take another household out of housing need, making better use of the existing stock. The extent of these benefits will depend upon the extent to which local providers target the product at social tenants, and can avoid providing the assistance to those who could access home ownership without it.

It is not possible to quantify such impacts but this Impact Assessment assumes that in general those options which deliver greater numbers of affordable home ownership properties will perform better under these criteria.

EMPLOYMENT AND WORK INCENTIVES IN THE SOCIAL SECTOR

Options 2 and 3 considered in this Impact Assessment would result in affordable rents at up to 80 per cent of market rents for a proportion of new social tenants many of whom would be eligible for Housing Benefit. Housing Benefit and other means tested benefits are frequently described as having 'unemployment trap' and 'poverty trap' effects:

- The 'unemployment trap' refers to a situation where people are little or no better off financially if they work than they would be out of work.
- The 'poverty trap' refers to a situation where people who are in work retain only a small proportion of any additional earnings because of tax and the withdrawal of benefits.

Theoretically, because of the withdrawal of Housing Benefit as income increases, the higher someone's rent, the longer and deeper the poverty trap they face and the worse their incentive to increase their level of income. This is true of tenants who under Options 2 and 3 would otherwise have been housed in social rented accommodation and in receipt of Housing Benefit. But for tenants who would otherwise have been housed in the private rented sector and in receipt of the Local Housing Allowance being housed in an Affordable Rent property would actually reduce their poverty trap and theoretically improve their incentive to increase earnings. In a small proportion of cases, higher rents extend the unemployment trap to more households. These impacts are discussed in more detail in the options appraisal section of this IA.

In practice other factors, such as awareness of the benefit system or lifestyle choices, may have at least as great an impact on work incentives and decisions around work than rent levels. In such a complex system and for such a varied client group there is mixed evidence on whether there is a relationship between low social rent levels and work incentives at present[41]. Given this uncertainty, it would not be sensible to attribute a strong impact on work incentives as a result of higher rent levels or an increased provision of housing.

Though the introduction of Universal Credit (to be phased in from 2013) will simplify the benefits system and potentially strengthen work incentives in the future, this Impact Assessment does not attempt to quantify changes in Housing Benefit and other benefit payments as a result of improved (or worsened) work incentives, nor the economic impacts (for instance, tax gains and losses and changes in GDP) that would result from changes in the level of employment amongst social sector tenants.

[41] *Impacts of rents on Housing Benefit and work incentives* (DWP, 2007); *Social housing and worklessness: Qualitative research findings* (DWP, 2008); *Ends and Means: the future roles of social housing in England* (John Hills, 2007)

2. Assumptions and supporting evidence

The following lists the assumptions used in financial modelling and value for money analysis, with supporting evidence where applicable:

DEVELOPMENT COSTS AND GRANT

- Total scheme costs, including land acquisition, works and on costs, for rented and shared ownership properties are assumed to be consistent with regional averages from 2008-11 the Homes and Communities Agency allocations data, excluding schemes benefiting from contributions under section 106 agreements. This suggests a national allocation-weighted average of £156,000 for rented general needs homes and £164,000 for affordable home ownership properties. Scheme costs are assumed to move in line with nominal national house price inflation, or to remain constant where this is negative.
- Current Homes and Communities Agency funding rates (payment as a proportion of total scheme cost) for general needs social housing and shared ownership properties are assumed to be consistent with those suggested by 2008/11 Homes and Communities Agency allocations data, excluding schemes benefiting from contributions under section 106 agreements (leading to higher funding requirements overall): on average 48 per cent for general needs social rented units and 20 per cent for shared ownership properties. These are used to calibrate financial appraisal modelling to determine (new) funding requirements under each option.

RENT LEVELS AND INFLATION

- Social rent levels including service charges for new build properties and those converted to Affordable Rent or shared ownership are assumed to be consistent with those of recent lets to new housing association general needs social properties (defined as the first let of the home), which, according to current policy, should be set in line with target rents. Local authority-level data on rents for 1, 2, 3 and at least 4 bed properties from the Continuous Recording of lettings in social housing database (CORE) (2008/9) are used for analysis and uprated as necessary.
- The potential Affordable Rent upon first letting is assumed to equal the lower of 80 per cent of market rent, taken to be equal to the median private sector rent for a property in the relevant local authority of the same number of bedrooms, and the relevant Local Housing Allowance rate. Given their large size, market rents will vary street by street and ward by ward within Local Authorities. In this context it is difficult to make accurate estimates of the rents that can be charged by Housing Associations based on a summary rent for the local authority as a whole. A detailed description of rent assumptions is provided below.
- The analysis uses data on market rents by numbers of bedrooms and local authority from the Valuation Office Agency Rent Service List of Rents (November 2009 to October 2010 sample). The List of Rents is a database of rents specifically collected for Local Housing Allowance purposes and the sample of properties achieved for the List aims to reflect a range of lettings information across the whole market that is representative of rent, condition and property type within neighbourhoods across a Broad Rental Market Area. Certain caveats apply when using the List of Rents data for Affordable Rent analyses. Firstly, many of the properties included on the List of Rents will not be comparable to a typical housing association unit in the same local authority; properties with the same number of bedrooms on the List of Rents may differ in terms of type, location, size or condition. These differences may result in the average market rent (from the List of Rents) being higher or lower than the average market rent for a housing association property in some areas. Secondly the List of Rents excludes information on rents for categories with

less than 5 records thus market rents may not be representative of all property types in an area.

- The analysis uses figures previously published by the Valuation Office Agency on what the new lower Local Housing Allowance rates would have been if they were based on the 30th percentile of rents in each Broad Rental Market Area as at December 2010. These data can be thought of as 'Shadow' 30th percentile Local Housing Allowances, reflecting changes to Local Housing Allowance rates as announced by the Chancellor of the Exchequer on 22 June 2010 which came into force in April 2011. In practice, Local Housing Allowance rates will have changed between December 2010 and April 2011. Weighted average Local Housing Allowance rates by local authority are estimated using the distribution of Local Housing Allowance caseloads across different Broad Rental Market Areas, providing a ceiling to Affordable Rent levels. As for the estimates of potential Affordable Rents described above, 30th percentile rental figures for Broad Rental Market Areas will mask a significant variation in rents across different streets and different wards. In this context it is potentially misleading to make assumptions about the implications of the upper limits on Local Housing Allowance rates and the scope for providers to charge 80 per cent of market rents based on broad rental market data covering such wide areas.
- An adjustment is made to potential rent income levels to account for possible reductions in rent income (either through arrears or lowered rent charges) due to the introduction of household benefit caps, as outlined in DWP's Welfare Reform Bill 2010-11. Rent levels are assumed to be the lower of (1) 80 per cent of the market rent, (2) the relevant Local Housing Allowance rate or (3) the income left for a workless non-disabled household to spend on housing after other benefit entitlements have been deducted from the household cap, assuming no spending is diverted to housing to make up shortfalls. While in practice households may make a range of responses to the change in policy, this approach assumes that landlords take a cautious view with regards to rent income. A weighted average rent is estimated for each property size based on assumptions made about the likely households that might occupy the home. Specifically, it is assumed that 1 bedroom properties contain childless couples; 2 bedroom properties contain couples with 2 children; 3 bedroom properties contain a mix of families with 2 (20%), 3 (40%) and 4 (20%) children; 4 bedroom properties contain a mix of families with 4 (50%) and 5 (50%) children; and 5 bedroom properties contain a mix of families with 4 (20%) and 5 (80%) children.
- Following such adjustments, local authority-level data on social, affordable, market and Local Housing Allowance rents for 1, 2, 3 and at least 4 bed properties are weighted using the corresponding CORE (2008/9) data on the number of general needs lets of new housing association properties to produce an average for each region and groups of local authorities[42] for use in analysis.
- Social rents are assumed to increase according to the Rent Influencing Regime, growing at RPI+0.5 per cent per year.
- Market rents are assumed to grow at 4 per cent per annum.
- Affordable rents rise at a rate of RPI+0.5 per cent for the duration of tenancy, but are rebased upon re-let, implying that average affordable rents for a cohort of properties should ultimately, in the long-run increase at the rate of market rent inflation. For the economic appraisal it is simply assumed that for its first two years an Affordable Rent property will see its rents rise at RPI+0.5 per cent, then at a rate equal to an average of social and market rent inflation for 10 years, and then at the rate of market rate inflation thereafter, ensuring a gap between market and affordable rent is maintained in the long term. The starting rent for Affordable Rent properties is assumed to grow in line with market rent inflation, again maintaining a gap between market and starting affordable

[42] Nomenclature of Territorial Units for Statistics 3, http://www.statistics.gov.uk/downloads/theme_economy/Nuts3_Tables_1-12.xls

rents. For financial appraisal analysis, which forms the basis of housing association financial planning it is assumed that affordable rent for a property increases at a long run rate of 4 per cent.

- Local Housing Allowances are assumed to grow in line with market inflation, apart from across the years 2013/14 and 2016/17, where they are uprated in line with the Consumer Price Index (CPI), to reflect the changes announced by the Chancellor of the Exchequer on 22 June 2010.
- RPI, CPI and earnings inflation are assumed to be consistent with forecasts made in November 2010 by the Office for Budget Responsibility[43]. Beyond these medium-term forecasts, RPI is taken to be 3.5 per cent, CPI is taken to 2 per cent and earnings inflation is assumed at 4 per cent.
- Drawing on DCLG analysis using the Department's Affordability Model, nominal annual house price inflation is assumed for the 6 years starting from 2010/11 as 0 per cent, -2.5 per cent, 2.5 per cent, 5.5 per cent, 6.6 per cent and 4.3 per cent, moving to a stable long run rate of 4.75 per cent thereafter[44].

SOCIAL HOUSING STOCK AND RE-LETS

- It is assumed that the same number of properties previously let by housing associations become available for re-let to new tenants in each year of the 2011-2015 Affordable Homes Programme as in 2008-09 (74,000).
- In financial modelling, the assumed number of re-lets converted varies across delivery scenarios and providers. The number of units assumed to be converted per new build unit varies across region, due to differences in rent differentials. Modelling assumes that all rented units are provided at 80 per cent of market levels (adjusted as described above). If lower rents were offered it is likely that there would need to be more conversions in practice to deliver a given number of new units.
- Data on housing association stock levels, total numbers of lettings and re-lets and their location are taken from the Regulatory Statistical Return for 2010[45].

FINANCIAL APPRAISAL AND DELIVERY MODELLING ASSUMPTIONS

- To test delivery scenarios for financial viability, individual housing association level data on rents, operating and interest costs and debt levels are taken from annual accounts data for the year ending 2010, provided to the Tenant Services Authority by organisations which manage at least 1,000 social housing units.
- Where affordable home ownership products are included (Options 1 & 3), they are assumed to make up 15 per cent of all delivery, with the remainder provided as rented units.
- For Option 1 it is assumed that the proportions of rented properties built with 1, 2, 3 and at least 4 bedrooms are 25 per cent, 45 per cent, 25 per cent and 5 per cent respectively[46]. Given the uncertain impacts on rent income of the household benefit cap policy, for Options 2 and 3 the relevant proportions assumed for new and converted units are 25 per cent, 49 per cent, 25 per cent and 1 per cent for London, 25 per cent, 45 per cent, 27 per

[43] http://budgetresponsibility.independent.gov.uk/d/economy_supplementary_tables_291110.xls
[44] For more information on DCLG's Affordability Model, see http://www.communities.gov.uk/publications/housing/affordabilitymodeldevelopments
[45] https://rsr.tenantservicesauthority.org/
[46] Broadly in line with recent HCA allocations. In practice, the mix of properties on new developments will vary.

cent and 3 per cent for the South East, and 25 per cent, 45 per cent, 26 per cent and 4 per cent for the rest of England.

- In modelling Options 2 and 3, it is assumed that only housing associations with positive net cash flows after operating costs and interest payments will develop and convert units. Those that do will limit the amount of additional debt which is taken on, ensuring that net cash flows are at least 7 per cent of operating and interest costs, as a proxy for the financial limits that cash flow requirements and interest cover covenants represent.
- In the absence of evidence on the likely distribution of future affordable housing development, it is assumed that the regional delivery distribution is consistent with the expected delivery profile of Homes & Communities Agency-funded social rent and low cost home ownership properties for the 2008-11 National Affordable Housing Programme.
- In modelling Options 2 and 3, average funding requirements for new units are calculated for each region, drawing on the weighted average rent data described above and NPV modelling of grant rates which takes into account the financial benefits of conversion of existing stock to higher rents. This assumes a 12 per cent reduction in the use of existing cross subsidy. It is assumed that the distribution across regions of a housing association's development reflects the location of their existing stock.
- Debt serviceable is calculated annually on the basis of the cash generated during a given year. In-year working capital fluctuations and debt repayment are not modelled.
- While gearing is not a modelling constraint, input and output levels of gearing for each provider are calculated to allow a sense check of the impact of the programme on providers.
- It is assumed that recent grant rates reflect bids with underlying investment appraisals that use a 6 per cent discount rate. Financial modelling assumes a 6.5 per cent discount rate for Option 1 and a 7 per cent discount rate for Options 2 and 3, given that the latter options' provide products which are closer to those of the private market.
- Effective interest rates for existing housing association debt are assumed to remain at 2010 levels, although it is clear that some lenders are looking for opportunities to re-price providers' back books. New debt is taken on at 0.5 per cent percentage point higher rates.
- The definition used in the analysis suggests a current average operating margin on rental income for new properties, including annual allowances for major repairs, of 40 per cent for social rent properties and 63 per cent for shared ownership properties. In practice this will vary by provider.
- Social sector operating costs are assumed to increase in line with RPI, with 2 per cent real terms efficiencies made across the Spending Review period (2011-2015).
- The average annual revenue housing associations receive from converting properties to affordable rent is calculated for each sub-regional group of local authorities based upon the rents data described above.
- Average capital receipts and rent payments from conversion to affordable home ownership are calculated for each sub-regional group of local authorities based upon the Homes and Communities Agency investment data, assuming property values are equal to 110 per cent of scheme costs.
- First sales to shared ownership buyers are assumed to equal 40 per cent of property value. In the case of conversions of properties to this tenure, the associated capital that can be applied to development is reduced by 20 per cent to account for repayment of debt. Rent payments on unowned equity are 2.75 per cent of property value.
- It is assumed that after five years, 3 per cent of shared ownership tenants will purchase the un-owned share of their properties each year. The associated provider financial benefits

that can be used to offset grant are reduced by 60 per cent of the property value at the point of conversion to account for obligations for capital grant recycling.

- Recycled Capital Grant Funding receipts from sales associated with units converted to affordable home ownership assume grant attached to such properties of £40,000, with the revenues applied to contemporaneous scheme costs to determine the resulting number of units delivered. Such units have the same distribution across social/affordable rent and affordable home ownership as assumed for the main output modelling. Further Recycled Capital Grant Funding from these second round units is ignored.

ECONOMIC AND EXCHEQUER APPRAISAL ASSUMPTIONS

- The present value of economic and exchequer impacts are presented in 2010-11 prices, deflated using the GDP deflator and discounted at a rate of 3.5 per cent. The long run GDP deflator is assumed to be 2.7 per cent.
- Average potential land value uplifts from increased housing supply are estimated using 2009 Valuation Office Agency data showing the differences in the values of land used across different uses by local authority, with an adjustment for the external environmental benefits of leaving land undeveloped, based on previous research[47]. Using data on the distribution of recent National Affordable Housing Programme delivery, a weighted average uplift is generated for each region, with an England average of around £40,000. Land value uplifts are assumed to move in line with house price inflation.
- For central scenarios it is assumed that the net increase in housing supply is equivalent to 50 per cent of the number of affordable homes built under each policy option.
- In distributional analysis, Family Resources Survey (2006/7 to 2008/9) data on the equivalised incomes of current social tenants, (Before Housing Costs measure) are used to produce average equity weights for London and non-London tenants separately, under the assumption that future tenants will have the same relative income characteristics. It is assumed that the value of economic subsidy (value of housing less rent paid) represents a transfer from the median household at the margin and that households' utility functions are logarithmic[48].
- Modelling has been used to inform assumptions for the proportions of tenants on Housing Benefit and the proportions of their rent covered in the following scenarios: tenants entering the social rented sector; tenants entering the new or converted Affordable Rent units; and tenants entering the private rented sector on Local Housing Allowance rates who might otherwise be housed in the social or Affordable Rent properties. Households are assumed to have characteristics as suggested by CORE (2008/09) data on housing association general needs lettings to new tenants. Combining this information with assumed property sizes (based on household size) and the Housing Benefit system rules, the Housing Benefit coverage under the three rent scenarios is estimated for use in economic appraisal, separately for the North, Midlands, London and the rest of the South of England. An adjustment has been made for incomplete take-up based on the amount of unclaimed Housing Benefit as reported by DWP[49]. The resulting England average proportions on Housing Benefit and proportion of rent paid by Housing Benefit for these tenants are 73 per cent and 83 per cent for social rent, 76 per cent and 85 per cent for Affordable Rent, and 78 per cent and 85 per cent for the private rented sector.

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[47] *Valuing the External Benefits of Undeveloped Land* (ODPM, 2004) http://www.communities.gov.uk/archived/publications/planningandbuilding/valuingbenefits
[48] See Annex 5 in *The Green Book* (HM Treasury, 2003) http://www.hm-treasury.gov.uk/data_greenbook_index.htm for more details on the distributional analysis methodology.
[49] http://research.dwp.gov.uk/asd/income_analysis/jun_2009/0708_HousingBenefit.pdf

- The proportion of households in receipt of Housing Benefit under the counterfactual of residence in the private rented sector is reduced by 10 per cent to account for households who would not otherwise be separately formed and residing in the private rented sector[50].
- Based on research carried out by Experian and Construction skills, it is assumed that, as at 2009, 21 gross year-long construction jobs are directly supported by £1m of housing investment excluding land acquisition costs. This figure is deflated over time in line with the GDP deflator and applied only to investment in additional housing that does not displace private supply.
- Informed by Scottish Government research, a multiplier of 1.59 is applied to estimates of construction jobs supported to estimate total gross employment effects given supply chain impacts. To account for displacement of jobs it is assumed that the net impact on employment is equal to one third of the gross impact.
- To proxy the economic benefit of net jobs supported, construction Gross Value Added per worker by region from 2009, uprated using earnings inflation, is applied to employment estimates[51].
- Income tax effects are estimated assuming each additional worker receives the median construction sector salary for their region[52], uprated by earnings inflation, and that tax is charged at the rates set by HMRC[53].
- National insurance impacts are estimated assuming a rate of 12 per cent is charged on earnings for additional workers[54].
- Impacts on Job Seekers Allowance are estimated by assuming, based on research by the Centre for Economic and Social Inclusion (CESI)[55], that 59 per cent of those additionally employed would have otherwise been claiming the benefit for the duration of the year of employment.
- The average council tax for a social sector dwelling is estimated by subtracting £350 from the council tax per dwelling figures published by DCLG[56], uplifted over time by CPI.
- Council Tax Benefit is paid to low income households under a similar system to that under Housing Benefit. Increases in payments are estimated using the same proportions assumed to be in receipt of this benefit as for Housing Benefit and the average proportion of council tax covered inferred from DWP data on average payments[57].

3. Risks and sensitivities

The proposal to reform delivery of affordable housing entails a new means of funding delivery. It is an untested model which depends upon a wide range of variables and behaviours. As such, it is very difficult to make accurate forecasts of delivery. Further, for a given scenario of

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[50] *Estimating Housing Need* (DCLG, November 2010) provides some analysis of the household formation impacts of social housing.

[51] Source: *Labour Market Statistics Regional Monthly Data* (Office for National Statistics, Dec 2009 figures) http://www.statistics.gov.uk/StatBase/Product.asp?vlnk=15084 and *Regional Accounts* (Office for National Statistics, 2009 figures) http://www.statistics.gov.uk/downloads/theme_economy/RegionalGVA2009.pdf

[52] Source: Annual Survey of Hours and Earnings, Office for National Statistics.

[53] http://www.hmrc.gov.uk/rates/it.htm

[54] http://www.hmrc.gov.uk/rates/nic.htm

[55] Centre for Economic and Social Inclusion (January 2011) http://www.cesi.org.uk/statistics/previous_months/lms_jan2011

[56] This is consistent with the approach taken in modelling of the New Homes Bonus - http://www.communities.gov.uk/documents/housing/pdf/1767788.pdf. Average council tax figures from http://www.communities.gov.uk/publications/corporate/statistics/counciltax201011

[57] http://research.dwp.gov.uk/asd/index.php?page=hbctb

delivery and conversion of properties to different tenures, the economic and exchequer impacts are sensitive to assumptions that are uncertain and difficult to verify.

This Impact Assessment develops three scenarios for each option, with a selection of key assumptions varying across each in such a way to ensure internal consistency as far as possible. In addition to the central scenario, assumptions for which are detailed in Section 2, an 'Upper' estimate generally provides assumptions which deliver more new homes, provide greater economic benefits per unit and feature lower exchequer costs. A 'Lower' estimate takes a more pessimistic view with respect to these outcomes. The following describes the key variables over which there is uncertainty and the approach taken to sensitivity analysis.

- Interest rates for new debt taken on by housing associations to fund new developments are important determinants of financial capacity. The actual rates that will be faced by the sector are uncertain and will be determined by a range of factors including developments in the wider economy and the perceived risks involved in social housing activity. This variable is adjusted across scenarios in financial modelling, set at higher rates in the Lower scenario and lower rates in the Upper scenario. Rates are set higher for Options 2 and 3 than for Option 1 to reflect the possibility that providers and lenders are relatively apprehensive under the new funding model.
- Linked to long term borrowing costs, discount rates used in financial NPV modelling reflect the opportunity cost of capital and will vary with the perceived risks associated with investments. Discount rates are varied across scenarios in this analysis to capture the effect of greater perceived uncertainty over rent income streams and the availability and effects of property conversions. In varying rates across scenarios, a similar approach is taken to that for interest rates.
- As explained in section 1 providers may apply cross subsidy to new developments of affordable housing drawing on the income sources from existing properties. The amount of cross subsidy provided per rented unit is adjusted asymmetrically across scenarios, with a potentially greater risk of reductions compared to increases.
- Scheme costs, a crucial determinant of housing supply, are subject to land price, wage and raw material inflation and are therefore uncertain. They are therefore reduced to provide an Upper scenario for development and increased for the Lower scenario.
- Where there is more uncertainty about future rental income streams, providers will want and need to convert more properties to Affordable Rent in order to make up any funding shortfalls. Therefore, for the Lower scenario, which has higher interest and discount rates it is also assumed that more properties are converted for every unit built, and vice versa for the Upper scenario.
- In the Upper scenario, it is assumed that a larger proportion of affordable housing is additional and improves general housing supply without displacing private units. This creates greater estimated economic benefits for a given level of delivery. A smaller proportion is assumed under the Lower scenario. This is consistent with the additionality of affordable housing increasing with the level of its overall delivery; with the first few units supplied potentially more likely to be displacing private supply at the margin.
- The proportion of households who are dependent upon Housing Benefit to pay for rent is a key determinant of the Government costs associated with each option. Given the proposed increases in flexibility over tenure for new social tenants, reforms to the benefits system and developments in unemployment and the economy, this assumption is subject to significant uncertainty but is likely to be lower under favourable economic conditions. Assumptions for Housing Benefit take-up in all housing tenures are decreased for the Upper scenario, generally reducing costs overall, and are increased for the Lower scenario.

Table 2 describes the specific assumptions made to produce a range of scenarios. In practice, should the conditions for development prove more unfavourable than expected, there are a range of mitigations available. In the case of Options 2 and 3, the number of properties converted to alternative tenures is assumed to vary modestly to offset adverse financial conditions in this assessment. Using greater numbers of conversions for each property built, and incorporating some outright property disposals, in such situations could help improve delivery and narrow the range of potential outcomes, though with adverse consequences for Housing Benefit costs.

This Impact Assessment also does not consider the number of affordable homes provided through section 106 agreements, for which grant payments would not be made. Should appetite or capacity for grant-funded affordable housing delivery fall to lower than anticipated levels, providers may be left with greater resources with which to supply homes under such agreements, helping support overall affordable housing supply. Further, at lower levels of delivery, it is possible that with effective targeting and consideration of value for money, scheme costs and funding requirements might be lower on average. Such variation in cost across scale of overall delivery is not accounted for in producing the lower scenarios presented here.

Table 2: Description of scenarios for sensitivity analysis

Variable	Lower scenario (compared to central)	Central scenario	Upper scenario (compared to central)
Interest rates	Option 1: +0.5%pts Options 2&3: +0.5%pts	Option 1: +0.5%pts on all new debt compared to current existing rates Options 2&3: +1.0%pts on all new debt compared to current existing rates	Option 1: -0.5%pts Options 2&3: -0.5%pts
Housing association discount rates	Option 1: +0.5%pts Options 2&3: +0.5%pts	Option 1: 6.5% Options 2&3: 7%	Option 1: -0.5% Options 2&3: -0.5%
Cross subsidy from existing sources	-25% cross subsidy from existing sources per rented unit.	Option 1: Current levels as a percentage of scheme costs Options 2&3: Reduction of 12% compared to existing levels per unit for rented units	+10% cross subsidy from existing sources per rented unit.
Scheme costs	+5%	Regional rates suggested by Homes & Communities Agency data	-5%
Converted properties per new build unit	+15% per new build unit in all regions	Varying by region	-15% per new build unit in all regions
Additionality of affordable housing	-10%pts	50%	+10%pts
Proportion of tenants on Housing Benefit	+5%	As determined by modelling	-5%

In the Upper scenarios for Options 2 and 3, delivery has been further restricted to ensure that the scale of development and conversions of properties compared to available re-lets among participating providers is not unreasonable, recognising that it is neither desirable nor possible to convert all re-lets.

4. Appraisal of Options

Option 1

OUTPUT SCENARIOS

This Option would directly increase the stock of social rented accommodation by an estimated 23,000 in the central scenario, with a range of between 19,000 and 27,000 units. Affordable home ownership provision would also be increased, by between an estimated 3,000 and 5,000 units. There would be no conversion of properties to alternative tenures.

Table 3: Option 1 delivery and conversions scenarios (2011-15)

	Low scenario	Central scenario	High scenario
New Social Rent units delivered	19,000	23,000	27,000
New Affordable Rent units delivered	0	0	0
New affordable home ownership units delivered	3,000	4,000	5,000
Total new units delivered	**22,000**	**27,000**	**31,000**
Units converted to Affordable Rent	0	0	0
Units converted to affordable home ownership	0	0	0
Total conversions	**0**	**0**	**0**
Cumulative effect on rented units (social and affordable)	19,000	23,000	27,000
Cumulative effect on affordable home ownership units	3,000	4,000	5,000
Cumulative affordable housing units	**22,000**	**27,000**	**31,000**
Notes: 1. Excludes units delivered via subsequent Recycled Capital Grant Fund payments. 2. Figures include partially funded units which are completed outside the Spending Review period, each assumed to contribute to total delivery by a half. 3. Totals may not equal the sum of components due to rounding.			

QUANTIFIED ECONOMIC IMPACTS OF AFFORDABLE HOUSING SUPPLY

As outlined in table 4, in the central scenario, this Option would directly increase affordable housing stock by an estimated 27,000 units, assumed to directly contribute an additional 13,000 homes to overall housing supply. This would bring estimated economic benefits of £517m, proxied by potential land value uplifts. The Upper and Lower scenarios create a range of direct housing supply impacts of between 9,000 and 19,000 properties, with corresponding economic benefits of between £335m and £724m.

This additional housing supply would also represent new economic output (measured as Gross Value Added) worth an estimated £592m in benefits to UK producers, associated with an additional 16,000 jobs. This is in addition to those effects captured in land value uplift. Across scenarios, there is a range of between £407m and £796m in Gross Value Added impacts and between 11,000 and 21,000 in job creation.

In addition to the economic benefits of expanding the provision of housing, there would also be benefits to social welfare arising from the sub-market provision of these properties to low-income households, thereby improving the distribution of UK consumption. Using the approach outlined in section 1, an illustrative estimate of these benefits under the central scenario is £540m, between Lower and Upper estimates of £426m and £646m respectively. This excludes potential distributional impacts arising from affordable home ownership provision.

In total, these effects suggest a central estimate of the present value of net economic benefits for Option 1 of £1,649m, with a range of between £1,168m and £2,166m.

EXCHEQUER IMPACTS OF AFFORDABLE HOUSING SUPPLY

Each scenario entails grant costs, discounted over the period, of £1,586m. In Option 1 under the central scenario this would be partially offset by Housing Benefit savings of £625m. This is a result of diverting households from the more expensive private rented sector to subsidised social rented housing, illustrating a trade off between revenue and capital expenditure. These Housing Benefit effects are uncertain and vary with both the number of units delivered, the alternative housing options for social tenants, and the amount of their rent met by benefits as illustrated by the Lower and Upper scenarios which provide a range of between £532m and £693m over 30 years.

Under the central delivery scenario, employment and council tax-related savings would amount to an estimated £212m, providing a conservative estimate given the exclusion of employer National Insurance Contributions effects, corporation taxes and changes in other income-related household benefit payments. The scenarios suggest a range of between £139m and £296m in savings.

Overall, there would be an estimated range of total exchequer costs, including grant expenditure, of between £915m in the Lower delivery scenario and £597m in the Upper delivery scenario, with a central figure of £749m.

Table 4: Option 1 quantified impacts (present value in £m's over 30 years where monetised)

	Lower scenario	Central scenario	Upper scenario
Non-monetised outputs			
Net increase in affordable housing stock*	22,000	27,000	31,000
Net increase in housing supply*	9,000	13,000	19,000
Jobs created (1 year duration)	11,000	16,000	21,000
Net government cost of which:	**£915m**	**£749m**	**£597m**
Homes & Communities Agency capital funding	£1,586m	£1,586m	£1,586m
Increase in Housing Benefit expenditure	-£532m	-£625m	-£693m
Wider net exchequer costs: employment and council tax	-£139m	-£212m	-£296m
Net economic benefits of which:	**£1,168m**	**£1,649m**	**£2,166m**
Economic benefits from increasing housing supply	£335m	£517m	£724m
Distributional benefits of social housing	£426m	£540m	£646m
Gross Value Added impact from construction activity	£407m	£592m	£796m
*Excludes units delivered via subsequent Recycled Capital Grant Fund payments. Note: totals may not equal the sum of components due to rounding.			

UNQUANTIFIED IMPACTS OF AFFORDABLE HOUSING SUPPLY

While proposals to reform the social housing system contained in the Localism Bill will change the interaction between the social housing stock and levels of housing need, affordable housing supply will continue to have a beneficial impact for households at risk of poor housing outcomes. New flexibilities contained in the draft legislation will allow the benefits of social housing to be better targeted to those most in need, while other measures such as decisions on the rules determining which categories of applicants qualify to be considered for social housing at the local level and 'home swap' schemes should offer the possibility of enhanced mobility within the sector. Tenants will continue to be provided with better security of tenure compared to the private sector.

As such, because of increased affordable housing supply, this Option would be expected to reduce housing need, including by helping concealed households and those at risk of overcrowding or with poor housing affordability. The inclusion of affordable home ownership provision in particular would help constrained first time buyers. Recycling of grant payments associated with such properties would also enable future development which would further help reduce need. For Option 1, the assumed reduction is housing need is proportionate to the number of new affordable housing units delivered under each scenario.

As explained in Section 1, provision of sub-market rents can theoretically mitigate unemployment and poverty traps relating to the benefits system. By improving overall housing supply and helping more areas become affordable for those on low incomes, this Option should also theoretically improve labour mobility. However, evidence on the effect of sub-market rents on work incentives is mixed and currently there are low levels of mobility among social tenants. Forthcoming reforms to Housing Benefit, the introduction of Universal Credit, and social housing reforms will change the interaction between affordable housing, work incentives and mobility. As such, no firm conclusion is drawn on the potential impact of this Option on such outcomes.

With 4,000 affordable home ownership properties estimated to be delivered in the central scenario, this Option would have a positive, though modest, impact on the ability of first time buyers to access home ownership. By targeting provision of affordable home ownership properties to social tenants, landlords would be able to free up rented units which could be allocated to other households with more severe housing need.

Option 2

OUTPUT SCENARIOS

By allowing providers to charge higher rents on properties converted to and built as Affordable Rent, this Option would expand the funding available for development, enabling a higher level of supply within a given grant budget. Here, affordable housing supply would be an estimated 48,000 in the central scenario, around 80 per cent higher than in the case of Option 1, though with no affordable home ownership properties provided. Associated with this development is an estimated 18,000 units converted to Affordable Rent. Given the greater reliance on private borrowing and the untested nature of the funding model, these estimates are subject to considerable uncertainty. Consequently, there is a greater range across scenarios compared with Option 1, with 32,000 new affordable units in a Lower scenario and 68,000 in a more optimistic assessment. The number of conversions to Affordable Rent implied varies between 14,000 in the former and 22,000 in the latter.

Table 5: Option 2 delivery and conversions scenarios (2011-2015)

	Low scenario	Central scenario	High scenario
New Social Rent units delivered	0	0	0
New Affordable Rent units delivered	32,000	48,000	68,000
New affordable home ownership units delivered	0	0	0
Total new units delivered	**32,000**	**48,000**	**68,000**
Units converted to Affordable Rent	14,000	18,000	22,000
Units converted to affordable home ownership	0	0	0
Total conversions	**14,000**	**18,000**	**22,000**
Cumulative effect on rented units (social and affordable)	32,000	48,000	68,000
Cumulative effect on affordable home ownership units	0	0	0
Cumulative affordable housing units	**32,000**	**48,000**	**68,000**
Notes: 1. Excludes units delivered via subsequent Recycled Capital Grant Fund payments. 2. Totals may not equal the sum of components due to rounding.			

QUANTIFIED ECONOMIC IMPACTS OF AFFORDABLE HOUSING SUPPLY

In the central scenario, this Option would directly increase affordable housing stock by an estimated 48,000 units, assumed to contribute directly to overall housing supply by 24,000 homes. This would bring economic benefits of an estimated £928m, an improvement of around 80 per cent over Option 1 - proportionate to the improvement in affordable housing delivery. The Upper and Lower scenarios imply a range of direct affordable housing supply impacts of between 13,000 and 41,000 properties, with corresponding economic benefits of between £498m and £1,580m.

It follows that the impacts on economic output would also be greater (by a similar proportion) than for Option 1, with an estimated £1,052m in benefits to UK producers, associated with an additional 28,000 jobs. Across the Option 2 scenarios though there is a wider range of between £598m and £1,721m in Gross Value Added impacts and between 16,000 and 45,000 jobs created.

Increases in rent on social sector existing properties converted to Affordable Rent would reduce the distributional benefits associated with sub-market rent in these cases relative to Option 1, though often this reduction will be mitigated by changes in Housing Benefit expenditure. Conversely, the additional supply generated by this Option means that more low-income households can benefit overall, though to a lesser extent in each case. An illustrative estimate of the net impact benefits under the central scenario is £985m (around twice those for Option 1), between Lower and Upper estimates of £663m and £1,395m respectively.

The significant distributional benefits per unit estimated to be obtained under Affordable Rent are as a result of the fact that there remains a significant differential between the ‘market’ rent of social properties and affordable rent and Local Housing Allowance levels, while the (generally smaller) differences in rent between social and affordable rent are tempered by Housing Benefit adjustments. Both effects are highly sensitive to assumptions on market rent levels, types of households allocated to such properties, and the extent of benefit claims thus highly uncertain and dependent on landlord and Local Authorities behaviour.

In total, these effects suggest a central estimate of the present value of net economic benefits for Option 2 of £2,966m, with a range of between £1,759m and £4,696m.

EXCHEQUER IMPACTS OF AFFORDABLE HOUSING SUPPLY

Grant costs for this Option are equal to those for Option 1, with a present value of £1,586m. However, the Housing Benefit consequences would be likely to entail greater costs for government in the long term. For properties converted to Affordable Rent, there could be an increase in benefit payments, assuming no change in the types of households allocated the properties. In practice as discussed above, the types of households allocated to Affordable Rent properties will depend on local decision making. New properties developed would be expected to lead to lower Housing Benefit savings from diverting households from the private rented sector compared to social rent provision, given the smaller gap between affordable rent and Local Housing Allowance rates, although there would be more properties with which to achieve such savings. In the central scenario the overall impact is an estimated £482m Housing Benefit cost over 30 years in present value terms. Across scenarios there is a range of between £388m and £560m.

With higher anticipated affordable housing supply compared to Option 1, there would be proportionately greater tax increases and benefit reductions associated with employment and council tax. Under the central scenario, these are estimated to amount to net savings of £305m. The scenarios suggest a range of between £164m and £525m in savings.

Overall, there would be an estimated range of total exchequer costs of between £1,810m in the Lower delivery scenario and £1,621m in the Upper delivery scenario, with a central figure of £1,764m – compared to £851m for Option 1.

Table 6: Option 2 quantified impacts (present value in £m's over 30 years where monetised)

	Lower scenario	Central scenario	Upper scenario
Non-monetised outputs			
Net increase in affordable housing stock*	32,000	48,000	68,000
Net increase in housing supply*	13,000	24,000	41,000
Jobs created (1 year duration)	16,000	28,000	45,000
Net government cost of which:	**£1,810m**	**£1,764m**	**£1,621m**
Homes & Communities Agency capital funding	£1,586m	£1,586m	£1,586m
Increase in Housing Benefit expenditure	£388m	£482m	£560m
Wider net exchequer costs: employment and council tax	-£164m	-£305m	-£525m
Net economic benefits of which:	**£1,759m**	**£2,966m**	**£4,696m**
Economic benefits from increasing housing supply	£498m	£928m	£1,580m
Distributional benefits of social housing	£663m	£985m	£1,395m
Gross Value Added impact from construction activity	£598m	£1,052m	£1,721m
*Excludes units delivered via subsequent Recycled Capital Grant Fund payments. Note: totals may not equal the sum of components due to rounding.			

UNQUANTIFIED IMPACTS OF AFFORDABLE HOUSING SUPPLY

It is uncertain whether lettings of Affordable Rent homes (either newly developed or converted from other tenures) have the same effect on housing need as those of social rented properties. However, it is expected that the availability of these homes would still reduce housing need and higher levels of development mean that more households could be supported overall under this Option. An estimated 25,000 more affordable housing properties would be delivered in Option 2 compared to Option 1 under central assumptions, with 18,000 properties converted in this scenario. Given the scale with which this Option improves supply, it is expected that housing need would be more effectively reduced overall through this Option, although there would be no additional assistance for constrained first time buyers. The labour market benefits of improving housing affordability can also be expected to be greater.

Option 2 will result in some households paying a (higher) Affordable Rent who would otherwise have paid a Social Rent. This will theoretically extend the poverty trap for most households and but will not worsen the unemployment trap for the large majority.

For the large majority of households provided with Affordable Rent properties who would otherwise have been allocated social rent properties, theoretically the unemployment trap is likely to remain the same as their net income would be the same in work at the lower (social) or higher (affordable rent) rent level, though the poverty trap would be theoretically extended for these households.

However against this, offering a greater number of households some form of sub-market rent (though not as large a subsidy) should theoretically reduce the unemployment and poverty trap for those households that would otherwise receive Local Housing Allowance in the private rented sector.

In terms of mobility, it is to be expected that some of the issues that currently face the social sector will continue given Affordable Rent units will continue be rationed. However the difference between market rent and affordable rent will narrow, potentially providing less of a disincentive and reducing the barrier for tenants to move between the tenures.

Option 3

OUTPUT SCENARIOS

As with Option 2, by allowing providers to charge higher rents on properties converted to and built as Affordable Rent, this Option would expand the funding available for development compared with Option 1. In addition, though, with 15 per cent of the relevant properties converted to and built for affordable home ownership in these scenarios, providers would also benefit from an up-front sales receipt and lower reliance on long term debt for finance, with the possibility of future receipts upon later sales of property shares. In particular, the use of a modest amount of non-Affordable Rent properties as part of development programmes may be beneficial where social rents are closer to market levels. This would further help improve supply for a given grant budget.

The modelling approach used cannot account for the fact that allowing greater flexibility in the tenures of new developments may also help them gain approval through local planning processes and encourage a wider range of providers to become involved in the Affordable Homes Programme. As such, the difference demonstrated between Options 3 and 2 in terms of development is probably understated.

Here, affordable housing supply associated with this budget would be an estimated 56,000 in the central scenario, around 107 per cent higher than in the case of Option 1 and 17 per cent higher than under Option 2. Associated with this development is an estimated 18,000 units converted to Affordable Rent and affordable home ownership. As for Option 2, there is a wide range, with 38,000 in a Lower scenario and 75,000 in a more optimistic assessment. The number of conversions to Affordable Rent or affordable home ownership implied varies between 16,000 in the former and 24,000 in the latter, over the four years.

Through recycling of capital grant, subsequent capital receipts from affordable home ownership units would generate funding to be allocated to housing provision, which would also contribute to the economic impacts outlined below.

Table 7: Option 3 delivery and conversions scenarios (2011-2015)

	Low scenario	Central scenario	High scenario
New Social Rent units delivered	0	0	0
New Affordable Rent units delivered	32,000	47,000	64,000
New affordable home ownership units delivered	6,000	8,000	11,000
Total new units delivered	**38,000**	**56,000**	**75,000**
Units converted to Affordable Rent	14,000	18,000	20,000
Units converted to affordable home ownership	2,000	3,000	4,000
Total conversions	**16,000**	**21,000**	**24,000**
Cumulative effect on rented units (social and affordable)	30,000	44,000	60,000
Cumulative effect on affordable home ownership units	8,000	11,000	15,000
Cumulative affordable housing units	**38,000**	**56,000**	**75,000**
Notes: 1. Excludes units delivered via subsequent Recycled Capital Grant Fund payments. 2. Totals may not equal the sum of components due to rounding.			

QUANTIFIED ECONOMIC IMPACTS OF AFFORDABLE HOUSING SUPPLY

In the central scenario, this Option would directly increase affordable housing stock by an estimated 56,000 units, assumed to contribute directly to overall housing supply by 28,000 homes. This would bring economic benefits of an estimated £1,086m, an improvement of around 110 per cent over Option 1 and 17 per cent over Option 2. The Upper and Lower scenarios imply a range of corresponding economic benefits from housing supply of between £595m and £1,745m.

Similarly, impacts on economic output would also be greater with an estimated £1,241m in benefits to UK producers, associated with an additional 32,000 jobs. Across scenarios there is a wider range, though, of between £595m and £1,745m in Gross Value Added impacts and between 19,000 and 50,000 in job creation.

Increases in rent on existing properties converted to Affordable Rent would again reduce the distributional benefits associated with sub-market rent in these cases. In addition, such benefits are assumed to be lost on conversion of social properties to affordable home ownership, which in practice may be a cautious assumption, particularly if such products are well targeted in future. An illustrative estimate of the net impact benefits under the central scenario is £905m, lower than for Option 2 due to a smaller cumulative direct impact on the number of rented units provided (44,000 compared to 48,000). There is a range of between £617m and £1,218m.

In total, these effects suggest a central estimate of the present value of net economic benefits for Option 2 of £3,233m, with a range of between £1,932m and £4,880m. This is 103 per cent greater than for Option 1 and 9 per cent greater than for Option 2.

EXCHEQUER IMPACTS OF AFFORDABLE HOUSING SUPPLY

Grant costs for this Option are equal to those for Options 1 and 2, with a present value of £1,586m.

Again, for properties converted to Affordable Rent, there could be an increase in Housing Benefit payments, assuming no change in the types of households allocated the properties. New properties developed would be expected to lead to lower Housing Benefit savings compared to social rent provision, although there would be more properties with which to achieve such savings compared to Option 1. In addition, we assume that the possibility of Housing Benefit savings is lost where a property is converted to affordable home ownership. In the central scenario the overall impact is an estimated £553m cost. Across scenarios there is a range of between £454m and £603m.

With higher anticipated affordable housing supply compared to Options 1 and 2, there would be proportionately greater tax increases and benefit reductions associated with employment and council tax. Under the central scenario, these are estimated to amount to net savings of £358m. The scenarios suggest a range of between £197m and £583m in savings.

Overall, there would be an estimated range of total exchequer costs of between £1,843m in the Lower delivery scenario and £1,606m in the Upper delivery scenario, with a central figure of £1,781m – compared to £851m for Option 1 and £1,763 for Option 2.

Table 8: Option 3 quantified impacts (present value in £m's over 30 years where monetised)

	Lower scenario	Central scenario	Upper scenario
Non-monetised outputs			
Net increase in affordable housing stock*	38,000	56,000	75,000
Net increase in housing supply*	15,000	28,000	45,000
Jobs created (1 year duration)	19,000	32,000	50,000
Net government cost **of which:**	**£1,843m**	**£1,781m**	**£1,606m**
Homes & Communities Agency capital funding	£1,586m	£1,586m	£1,586m
Increase in Housing Benefit expenditure	£454m	£553m	£603m
Wider net exchequer costs: employment and council tax	-£197m	-£358m	-£583m
Net economic benefits **of which:**	**£1,932m**	**£3,233m**	**£4,880m**
Economic benefits from increasing housing supply	£595m	£1,086m	£1,745m
Distributional benefits of social housing	£617m	£905m	£1,218m
Gross Value Added impact from construction activity	£720m	£1,241m	£1,917m
*Excludes units delivered via subsequent Recycled Capital Grant Fund payments. Note: totals may not equal the sum of components due to rounding.			

UNQUANTIFIED IMPACTS OF AFFORDABLE HOUSING SUPPLY

As for Option 2, it is difficult to directly apply evidence on the effects on housing need of social rent provision to Affordable Rent supply, but it is expected that this Option will better address housing need if it can generate sufficient improvements in supply. An estimated 29,000 more affordable housing properties would be delivered in the central scenario compared to Option 1, and 8,000 more compared to Option 2 (though with 4,000 fewer rented properties after the effects of conversions), with 21,000 properties converted. With inclusion of affordable home ownership provision, it is expected that housing need would be more effectively reduced overall compared to Option 1 and, to a lesser extent, Option 2.

Similar impacts as detailed in Option 2 relating to the extension of the unemployment and poverty traps apply to Option 3. However, with some delivery of affordable home ownership there will be fewer households re-housed from the private rented sector (where they are likely to pay higher rents). To a modest extent there may also be more opportunities to improve tenant mobility through targeting of affordable home ownership towards social tenants.

Specific Impacts tests

Statutory equalities

An initial screening of the equality impact of the preferred Option was carried out and indicates that a full equality impact assessment is required. This will also be published shortly.

The Affordable Rent policy is not intended to bring about any disadvantage for any particular group of people. Rather it is aimed at supporting the most vulnerable in society by maximising the delivery of new social housing, making the best possible use of the existing social housing stock and matching delivery of new build to housing need. The policy aims to provide an offer which is more diverse for the range of people accessing social housing, providing alternatives to traditional social rent and making the provision of social housing more flexible.

Economic impacts

COMPETITION

The 2011-2015 Affordable homes Programme Framework document provides information related to competition under the new funding model, which is not expected to increase or restrict competition amongst providers relative to the existing programme. The framework indicates that providers should consider and maximise value for money by bearing down on the costs of new supply and in the 2011-15 Programme providers will also be required to work with the Homes & Communities Agency on an open book basis. Intensive competition to secure schemes in the period up to submitting proposals is strongly discouraged due to its likelihood of driving up costs. Finally, the framework states that providers are not expected to utilise funding to pay for unnecessary increases in land or works costs through higher profit margins.

SMALL FIRMS

The Affordable Rent policy does not introduce any new regulation for business. Whilst there will be costs associated with the condition that providers signing a contract for allocations of more than £3m from the Affordable Homes Programme must publish quarterly expenditure figures, these costs are not expected to be incurred by small businesses.

The Affordable Rent policy may introduce further costs to providers, for example if they grant flexible tenancies and re-let properties on a more regular basis. However, these costs are not expected to disproportionately affect small firms and are likely to increase relative to the amount of stock held by providers. Further it is at the discretion of providers to choose the types and lengths of tenancies they issue.

The Affordable Rent funding model relies upon the conversion of social rent properties to provide higher Affordable Rents. In theory this should allow small and large providers to achieve the same relative increase in the size of their housing stock. In the framework document providers are particularly encouraged to include smaller, specialist and community based organisations in consortia arrangements. Offers which include a range of provision and meet a range of needs, including where this is delivered through smaller local providers who can bring forward capacity and who are likely to be well placed to meet local needs will be favoured in assessment. The framework also provides details of specific considerations for smaller organisations.

ENVIRONMENTAL IMPACTS

The increased development that takes place as a result of the Affordable Rent policy may result in environmental impacts in respect of the consumption of land and carbon emissions through increased construction and levels of economic development.

Our policy is not deemed to meet the threshold required by DECC to publish the environmental impacts. This is because it is estimated that our policy will emit less than 0.1Mt/CO2 annually.

SOCIAL IMPACTS

Local authorities and providers will be responding to and addressing local housing needs via the Affordable Homes Programme and the Affordable Rent policy. This could lead to positive social impacts. Furthermore, by affecting the way that social housing is managed, Affordable Rent is likely to have some beneficial impacts on the health and well being of households.

It is not anticipated that there will be any adverse impacts in terms of human rights or the justice system and a full impact assessment has not been undertaken with respect to these measures.

RURAL PROOFING

The Defra classification of local authority districts and unitary authorities[58] provides a means of categorising each local authority as predominantly rural, significantly rural or predominantly urban. This classification has been used to examine the financial viability of the Affordable Rent model in rural and urban local authorities via analysis of estimated social and affordable rent differentials and numbers and proportions of existing properties becoming available for re-let. Higher rent differentials and numbers of re-lets indicate the potential for developing providers to convert existing social properties to Affordable Rent and generate sufficient income to fund new affordable units. A low rent differential or number of re-lets alone does not indicate that the new Affordable Rent model in financially unviable in the local area. Robust estimates of rent differentials and re-lets of existing properties are not available at a sub-local authority level.

The analysis shows that 26 out of 176 (15%) local authorities classified as predominantly urban have both a low estimated rent differential between social rent and Affordable Rent properties and a low number of re-lets compared to 28 out of 125 authorities (22%) classified as predominantly rural and 10 out of 53 local authorities classified as significantly rural (19%)[59,60.]

Thus, although the proportion of local authorities where the Affordable Rent model appears less financially viable is higher for the predominantly rural group than the predominantly urban group, the model appears financially viable for the large majority of rural local authorities. Furthermore, based on this assessment, all but two of the predominantly rural local authorities where the Affordable Rent scheme appears potentially less financially viable have a higher than average proportion of their existing stock being re-let to new tenants. The proportion of existing properties becoming available for re-let to new tenants varies widely across rural and urban

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[58] Defra (2009) http://www.defra.gov.uk/evidence/statistics/rural/rural-definition.htm

[59] Data on re-lets from CORE relate to 2008-09 financial year and analysis based on 354 local authorities in England in existence before local government restructuring on 1 April 2009.

[60]354 local authorities grouped in quintiles on basis of rent differential, number of re-lets and proportion of stock available for re-let to new tenants. A local authority said to have a low rent differential or number of re-lets is found in the bottom quintile.

local authorities but on average is virtually identical across the three groups of authorities discussed above[61].

In some local authorities the data do not show the impact of rent differentials on smaller settlements' housing supply, as larger settlements within a rural local authority will skew the rents data. The risks of the Affordable Rent model having an adverse impact on the supply of affordable homes in rural areas are further mitigated given that one of the aims of the new programme is to meet housing need at a local level. The 2011-2015 Affordable Homes Programme framework document states that providers are particularly encouraged to include smaller, rural, specialist and community based organisations in consortia arrangements so that proposals will better reflect local need and that the Homes and Communities agency will favour in assessment offers which include a range of provision and meet a range of needs, including where this is delivered through smaller local providers who can bring forward capacity and who are likely to be well placed to meet local needs, as identified by local authorities.

SUSTAINABLE DEVELOPMENT

It is not anticipated that this policy will have any negative implications for sustainable development. Indeed under the Affordable Rent policy providers will be less reliant on government grant to fund new development than in previous years.

D. Summary and preferred Option

The analysis presented in section C compares the three policy options in terms of key outcomes. As illustrated by chart 1, Options 2 and 3 are estimated to provide greater numbers of new affordable housing units and this suggests that housing need would be better addressed under a system of reformed social housing delivery. Under this approach, the analysis suggests that delivery levels are more uncertain. However, this does not fully take into account a range of mitigations such as further adjustment in the number and type of converted properties, variation in scheme costs across scale and wider impacts on grant-free units excluded from this IA.

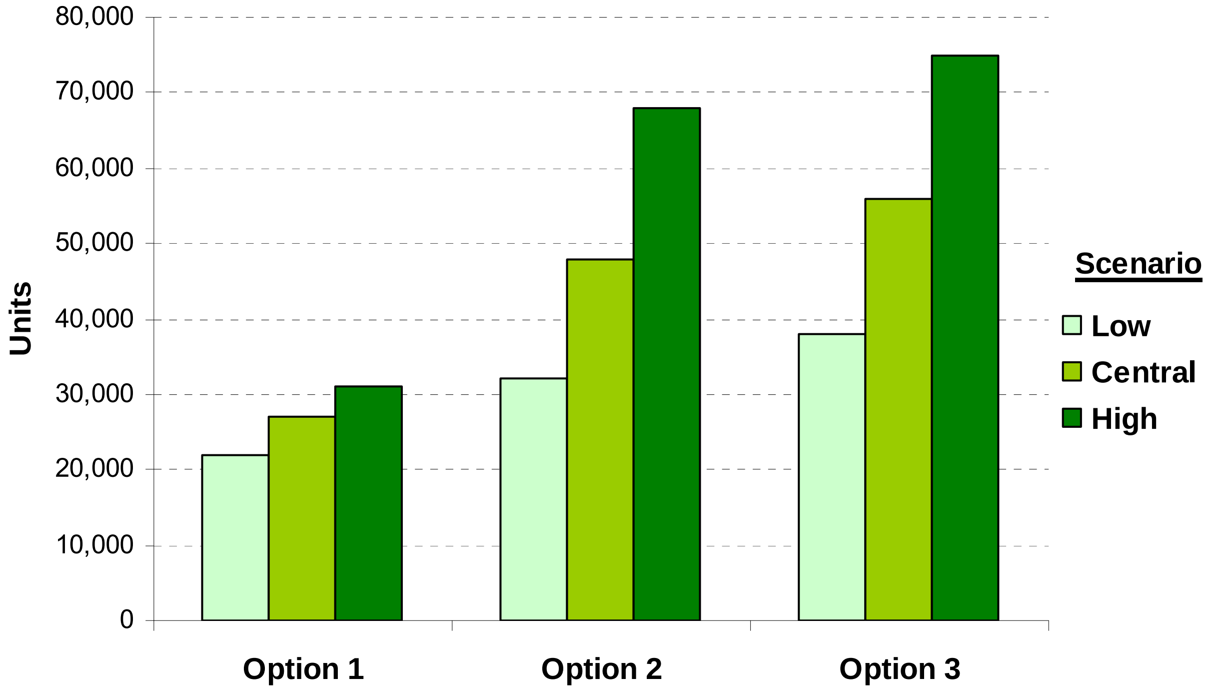
The estimated number of new units provided is maximised under Option 3, due to the inclusion of affordable home ownership, the addition of which also suggests greater benefits for first time buyers compared to Option 2. Incorporating such flexibility over tenure should also help secure the progress of developments and the involvement of a wide range of providers.

Correspondingly, Options 2 and 3 would appear to provide the greater but more uncertain economic impacts in terms of housing supply, its associated output effects and the benefits of improving affordability for low-income households. Again, Option 3 is estimated to provide the greatest benefits in this respect, as illustrated in chart 2.

Chart 3 demonstrates the trade off between capital and revenue expenditure, with the Affordable Rent Options (2 and 3) bringing greater costs to government through increases in Housing Benefit expenditure due to rent increases but set against a lower capital payment per new unit. The higher Housing Benefit is partially mitigated by the effects of increased housing construction under these higher delivery options, resulting in higher income and council tax revenues. Options 2 and 3 are broadly comparable in this respect, with increased Housing Benefit costs but higher employment benefits in the latter. Correspondingly, net government costs are lower under more optimistic assumptions on development.

This analysis suggests that, given a fixed capital budget and within the constraints on government expenditure over the Spending Review period, Option 3 delivers the greatest net economic benefits, maximises the delivery of new social housing, provides the most diverse range of products for those accessing social housing and would deliver the largest reduction in housing need. On this basis, despite higher estimated costs to government in the long term, it is the preferred Option.

Chart 1: Comparison of affordable housing delivery across options



Note: Excludes units delivered via subsequent Recycled Capital Grant Fund payments.

Chart 2: Comparison of net economic benefits (30 year NPV) across options

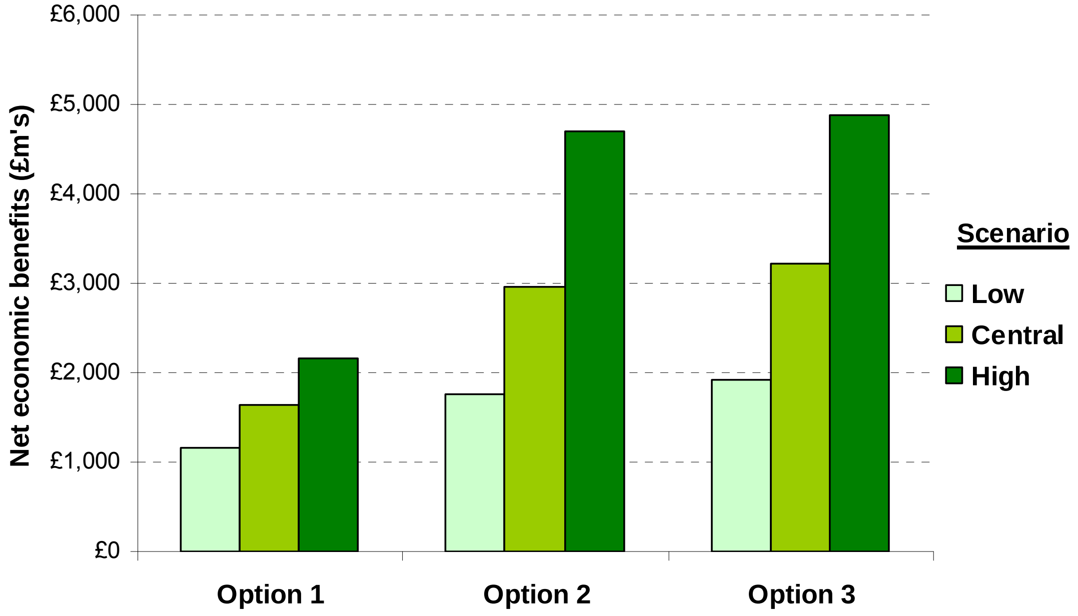
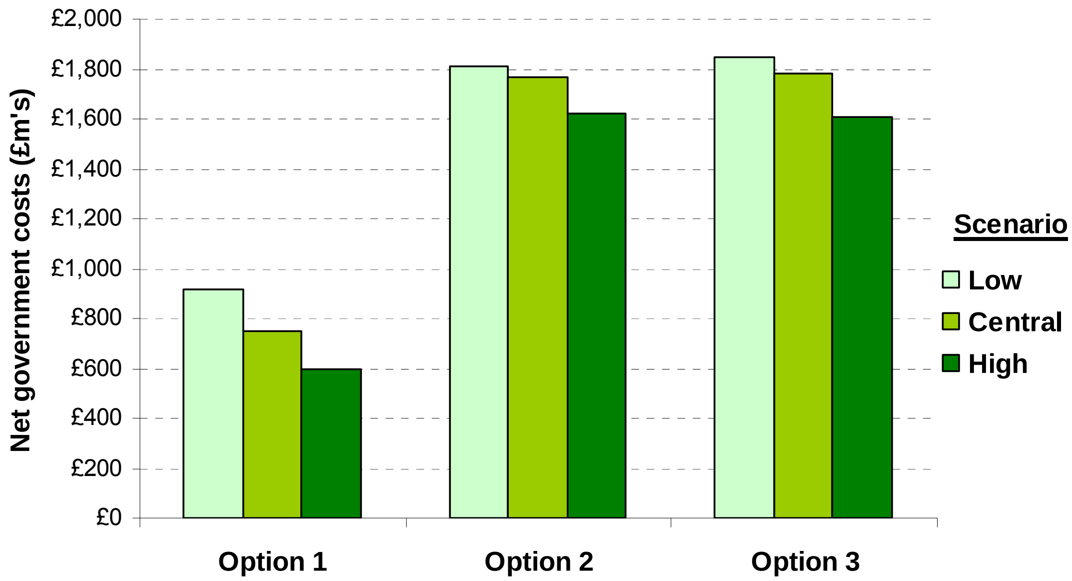


Chart 3: Comparison of net government costs (30 year NPV) across options



MONITORING

The Affordable Homes Programme 2011-2015 framework document sets out the information required from potential providers submitting package offers for the new Affordable Homes programme. Although it is also recognised that it will not be possible, at the point at which offers are submitted, to be precise about all details of the package offer over the whole 2011-15 period.

The framework documents also sets out ongoing information requirements from approved package providers, such as completion of the Continuous Recording (CORE) log for all Affordable Rent lettings. The CORE log has been adapted in 2011-12 to reflect the new Affordable Rent product. Approved package offer scheme costs and income will be published quarterly, as well as details of delivery of both new supply and conversions. This will be a valuable source of data for providers and government and support the continual drive for improved efficiency.

EVALUATION

We intend to evaluate the Affordable Rent policy during the spending review period in order to review its take-up, costs and benefits. The evaluation will assess Affordable Rent against the policy's intended outcomes, including meeting local housing need and the effectiveness of the new delivery model.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; The arrangements for ongoing review of the Affordable Rent model were set out in the 2011-15 Affordable Homes Programme - Framework.
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] Reviews will assess whether the Affordable Rent model is achieving the outcomes agreed in framework contracts signed between HCA and providers for the delivery of the 2011-15 Affordable Homes Programme.
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] The HCA will conduct quarterly contract reviews with each provider to consider actual delivery achieved and a forward look at new supply proposals to be delivered and anticipated conversions/dispsals. The HCA will also conduct a strategic review of the operation of the framework contract for the Affordable Homes Programme. This will be conducted jointly with providers on an annual basis.
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] The quarterly contract reviews will consider actual delivery achieved against the level of delivery envisaged under the original contract signed by each provider.
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] The quarterly contract reviews and annual strategic review will allow for modifications to be made to improve delivery. Where delivery is behind that envisaged under the framework contract, a fundamental principle will be that the provider will have an opportunity to put forward proposals to increase or accelerate delivery in the first instance. The HCA will take a view on the realism and likelihood of achievement of remedy, informed by the scale of variation and the stage reached in the programme. The key objective of contract reviews and the approach to variations will be to maintain (or increase) the number of new homes delivered.

Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] Full details of the reporting requirements in respect of delivery of new supply, conversions and disposals will be included in the framework contract. The framework contract will require providers to report all affordable homes delivered with nil grant input. Providers will be required to include information on properties let on Affordable Rent in their CORE (Continuous Record of Lettings and Sales in Social Housing in England) returns. A separate CORE log will be issued for Affordable Rent lettings.
Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here]