

Housing Finance Aspects of the Green Paper

Edited by Alex Marsh and John Hills

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Centre for Analysis of Social Exclusion

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Foreword

This report contains key points from presentations and discussions at a round table meeting held at the London School of Economics on Monday 24th July 2000. This meeting was organized by CASE and the University of Bristol to give an opportunity for housing finance academics to discuss with officials of the Department of the Environment, Transport and the Regions the financial aspects of the Housing Green Paper, *Quality and Choice: A decent home for all* (DETR/DSS, April 2000).

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1. Comments on Chapter 4: Encouraging Sustainable Homeownership

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Introduction

Chapter 4 of the Green Paper sets out a number of key policy initiatives designed to encourage and support sustainable home ownership. While there is no explicit discussion of the context, much of the Chapter is clearly predicated on an acceptance of the changing structure of the housing market and the conditions under which homeownership has now to be managed. The key policy areas identified (excluding policy towards improving quality) are:

- protection for homeowners in temporary financial difficulties
- safeguards with respect to the mortgage selling process
- improvements to the home buying and selling process
- low-income access
- leasehold reform.

In many of these areas the Green Paper confirms the nature and direction of existing policies. Typically, proposals for further initiatives are framed within current assumptions and parameters (the emphasis on private welfare markets, individual responsibility, the co-operation of lending institutions, the appropriateness and effectiveness of current structures of consumer regulation etc). In the context of the Green Paper as a whole, the discussion of homeownership lacks any of the sense of change that characterises discussion of some other issues. However, this is not to say that policy towards home ownership as set out in the Green Paper is unproblematic. This can be illustrated by a focus on two of the policy areas noted above.

Protection for homeowners in temporary financial difficulties

This policy objective is to be met in two ways; encouraging the provision of more flexible mortgages and by private market insurance for mortgage payments (MPPI) in the event of a complete loss of income.

The Green Paper presents the development of flexible mortgages as unproblematic, despite the lack of any evidence base to support this view. 'Flexible mortgages' is a potent marketing term. The current growth is a result of both truly innovative products (for example, current account mortgages) and the re-branding of existing products with minimal changes – typically short payment holidays or a switch to monthly or daily interest calculations). Important issues are:

- Which aspects of flexibility are able to contribute to the aim of sustainable home ownership? What proportion of flexible mortgages offer the facility to overpay or a payment holiday and what proportion of those with flexible mortgages have the capacity to overpay? Which segments of home owners are taking flexible mortgages?
- The relationship between flexible mortgages with the current social security safety-net. For example, flexible mortgages are characterised by rapidly fluctuating outstanding interest while ISMI makes an assumption of stability. The capacity of borrowers or lenders with a current account mortgage to identify the outstanding mortgage balance on

the original mortgage (which becomes a redundant term) is also questionable. Flexible mortgages may also contribute to the problem of payment difficulties rather than to their solution by facilitating additional borrowing.

The second policy towards protecting mortgagors in financial difficulties is through the provision of MPPI. The Green Paper acknowledges a number of problems with the MPPI market (cost, take-up, etc.) but suggests that they are amenable to solution, not least through the benchmark product. The Green Paper implicitly endorses the achievement of the proposed take-up rate of 55%. The research evidence questions many of these assumptions raising some key issues about this policy reliance on MPPI. These include:

- Whether key risks are insurable by the private market? In particular, is unemployment insurable? Can the product respond to the terms and conditions that pertain in a flexible labour market?
- While the benchmark product has increased transparency is it primarily confirming minimum standards? If so, how can product innovation be addressed?
- What are the mechanisms for increasing market penetration? (currently 19%). What leverage can Government exert? A key issue for discussion is the need for compulsory MPPI with the insurance forming an integral part of the mortgage product.

The Green Paper also puts forward three possible longer term proposals as options; to offer ISMI at 2 months to homeowners with MPPI but who suffer an uninsurable event and to allow more generous treatment of MPPI in assessing benefit entitlement. Either or both of these could make an immediate, significant contribution to the better protection of mortgagors. The third proposal to align MPPI and ISMI more effectively by extending the ISMI wait period to 14 months has to be predicated on both much wider take-up of MPPI and early access to ISMI for uninsurable events. Without these conditions in place, the extension of the wait period is likely to encourage rapid possession of uninsured borrowers. Such a proposal would, however, have the benefit of removing the current administrative difficulties associated with ISMI/MPPI overlap. This proposal raises the issue of regulating lenders with respect to initial forbearance. Experience in the early 1990s suggest that voluntary agreements are inadequate. Currently, forbearance is inadequately covered in the Mortgage Code.

The Green Paper proposes two changes to the State support for mortgagors (ISMI).

- An extension of the linking arrangements from 13 to 52 weeks which addresses the disincentive mortgagors face in taking casual temporary work.
- An ISMI run-on of 4 weeks on a return to work which is likely to limit the risk of arrears.

Both are positive developments addressing well documented disincentives to a return to work. Significantly, this is the first step towards equalising the treatment of low income mortgagors and tenants with respect to support with housing costs. However, overall, the Green Paper leaves as an unaddressed, major, issue the full implementation of a tenure neutral housing allowance scheme that would effectively underpin low income homeownership. This is one of the major outstanding issues within home ownership policy. Without this, and in the light of the comments above, the current level of homeownership may be unsustainable.

Safeguards in the mortgage selling process

The Green Paper identifies consumer detriment in the mortgage selling process associated with the lack of transparency and non-comparability of mortgage information. It aims to address this problem by building on, but replacing, the voluntary Mortgage Code regulation by the introduction of statutory regulation of the mortgage selling process where the FSA will supervise compliance with the requirement for clear and open disclosure. Kite marked mortgages are also proposed, conforming to CAT standards.

Statutory regulation is to be welcomed, not least because of the evidence that the voluntary Mortgage Code offers relatively weak regulation and is characterised by considerable non-compliance. These proposals for statutory regulation while important are, nevertheless, partial and a key issue is the *direct* exclusion from this framework of the selling activities of mortgage intermediaries and of the provision of mortgage advice. Under the new regulatory system, lenders are to be held responsible for the selling of their products by intermediaries (complicating the structures of compliance and potentially reducing the number of mortgage intermediaries as lenders seek to reduce the effort in monitoring). The absence of regulation of mortgage advice reflects the assumption that mortgage products are straightforward and that once borrowers have clear information, robust and appropriate decisions can be made. This is the *caveat emptor* principle that governs all consumer regulation and that has not to date prevented mis-selling. Research questions the assumption that mortgages are straightforward, identifies the limited financial literacy amongst many consumers and indicates the widespread reliance on mortgage advice. Thus, while a start is outlined in the Green Paper, any policy to bring about a substantial reduction in consumer detriment is likely to require a more comprehensive form of regulation than is proposed in the Green Paper.

Support for low income entry to homeownership

The Green Paper suggests continuing support for the entry of low income households into home ownership through Right-to-Buy and other low cost schemes. In the light of the current figures on mortgage arrears and level of payment difficulties, and the evidence that more low-income households are leaving owner occupation than entering, such encouragement to entry should be questioned. In addition, the Starter Home Initiative responding specifically to the issue of low-income, key worker demand in high price areas is problematic. The criteria for such initiatives look robust and, for example, there is a question as to whether the house prices in the bottom quartile in some local housing markets can be afforded by those on low incomes or by households with only one earner. Further, such initiatives may be redundant as the price/income/location relationships shift over time.

Brief Summary

The commitment to home ownership remains central to housing policy. However, the current level of homeownership is questionable as are the key policies towards safety-net provision. In this context, the lack of a tenure neutral housing allowance is a critical issue.

Key points from the discussion of low income home ownership

- Is it realistic to think that MPPI coverage could reach 55%? Even if it did, would it be offering value for money? Strong scepticism was expressed about this aim, rather than accepting that there are people for whom home ownership is not sustainable.
- How could the ‘uninsurable events’ which ISMI would cover early on be defined? Could risks be separated like this, given the way in which short-term policies did not, in fact, cover against general increases in unemployment risks?
- Further, evidence suggested that cuts in ISMI had not, in fact, incentivised purchase of MPPI. Instead there was a large group of people without coverage.
- The Government’s aim was to encourage home ownership, in line with aspirations, but purchasers should recognise the risks they were taking. State protection might be supporting lenders, not borrowers. However, it was suggested that there was then a problem in encouraging people into something which was unsustainable and into thinking that the risks could be removed.
- The ‘Starter Homes’ initiative was still quite open in the form it would take. There would be a challenge fund into which local authorities would put bids. These could include existing forms of low cost home ownership.

2. Promoting a healthy private rented sector: Chapter 5 of *Quality and Choice*

Alex Marsh, School for Policy Studies, University of Bristol

Introduction

Chapter 5 of the Green Paper covers a range of topics relating to the private rented sector, but the focus is on expansion of the sector and improvement in the quality of both the stock and housing management. The key to expansion is seen to be encouraging the involvement of large private institutional investors. A number of mechanisms are seen as contributing to improvements in quality, but perhaps the most novel proposal is the possibility of making Housing Benefit payments, in particular circumstances, contingent upon quality.

In this note I want to make some comments under four headings:

- Clarifying basic assumptions
- Encouraging investment
- The use of Housing Benefit to improve standards
- Voluntary regulation, self regulation and licensing

Clarifying basic assumptions

The chapter's opening discussion notes the relatively small scale of the private rented sector in the UK and that it is an easy access tenure for the young and the mobile. These are conventionally seen as households that are not ready to enter home ownership, or for whom home ownership does not make sense at the current time, given transaction costs. This leads the government to the view that not only is a better quality and better managed private rented sector desirable but also that it should be larger than it is at present (para 5.7).

It is important to recognise that this is a partial picture of the private rented sector. It omits the 'life time' renters who remain in the sector from the time when private rented was a majority tenure, often in regulated tenancies. Perhaps more significantly it seems to de-emphasise those who are unable to access other tenures because of inadequate or unstable incomes or because they are not eligible for – or, increasingly, because they have been excluded from – social housing. Because all these groups rent privately in largely unrelated submarkets it is now conventional to note that 'the' private rented sector is a largely artificial construct.

For current purposes this is significant because if policy makers wish to set some objective, or have some aspiration, regarding the size of the private rented sector then it is necessary to disentangle the various components of the picture and determine in which sub-market growth is desirable. In this respect it would be helpful to distinguish between stocks and flows more clearly. The stock of private dwellings may be relatively small at present, but is it undesirably small? It most probably depends on which part of the sector we are concerned with. Given the temporary nature of the demand for private renting from mobile households, it may be the case that the stock does not need to be extensive nor expand dramatically to meet demand in particular localities.

If we examine the trends in tenancy type it is clear that the easy access, temporary and relatively high turnover part of the sector expanded over the mid-1990s (assured shortholds increased by 41% over the period 1993/94-1997/98, Wilcox, 1999, Table 49). Yet the number of regulated tenancies declined by 50% over the same period (from 407,000 to 205,000) which means that the total number of tenancies has not changed dramatically. Given the composition of the population of regulated tenants it is inevitable that this sub-sector will continue to decline. It is therefore not clear whether, in aggregate, an increase in the size of the sector should be either expected or necessary. Similarly, it is clear that there are local housing markets which exhibit excess supply in the private rented sector – indeed the latter part of chapter 5 is concerned with such areas. If we assume that in the medium term that excess supply will decrease while supply in areas of excess demand will increase then again it is not clear *a priori* whether one would expect to see an aggregate increase in the stock of private rented dwellings.

If, however, we accept that an aggregate increase in the size of the private rented sector is necessary then it must flow from some combination of the assumptions that:

- (i) at any one time there will be more mobile households
- (ii) that a larger number of households move into the private renting before moving into owner occupation, or such households postpone for longer (possibly indefinitely) their move into owner occupation
- (iii) there will be a larger pool of households who cannot access one of the other tenures

Which of these assumptions is given primacy is significant when we consider the supply response because they are largely separate sub-markets. It is clear that the rental yields available vary spatially. Yields are highest in the smallest properties and, broadly speaking, in the regions with the less vibrant economies. If mobility is directed towards the more dynamic local economies – as might be expected – then it may be that the level of house prices – which largely drives the level of rents – places a constraint on yields and suppresses the supply response, at least from highly geared small landlords. For households to choose to remain in the private rented sector when owner occupation is an option (assumption ii) then clearly the appropriate mix of accommodation needs to be available. Yet, for larger properties yields are lower and hence the supply response is likely to be more sluggish. If, in contrast, assumption (iii) predominates then a key factor in the generation of an adequate supply response will be the future of Housing Benefit, which would not necessarily be an issue for (i) – if we assume mobility is job-related – or (ii).

One thing that chapter 5 lacks is explicit discussion of the ‘central dilemma’ of the private rented sector, which is that rents required to generate the yields that make private landlordism attractive are out of reach of many of those who wish to, or have to, reside in the sector. It is, of course, implicit in the discussion of encouraging investment in private renting, but that discussion is conducted entirely with respect to the supply side, without reconnecting to the demand side of the market.

This issue of finance is a further element in understanding why the UK has a relatively small private rented sector. The Green Paper identifies perceptions of poor quality stock and management as generating a poor image – at least partly unjustified – which is an impediment to the growth of the sector. What it does not acknowledge is that most consumers perceive it also as poor value. Not so much poor value in the sense that you receive a poor service for the money you pay, but in comparison with owner occupation. The popular

perception is that you are ‘throwing money away’ by purchasing a service, when compared to purchasing a capital asset and self-provisioning management and maintenance services. Improving the quality of the stock and management may well enhance the reputation of the sector and affect decision making for some housing consumers, but it does nothing to address these deeply ingrained views of the relative merits of renting and owning.

Encouraging investment

In terms of encouraging institutional investment in the sector, the government sees creating an environment of certainty and confidence as the key factor. The chapter raises the possibility of tax changes to increase the incentives to institutional investors, but there is a general presumption that there should be no special treatment. The government sees ruling out both reform of the assured shorthold regime and the reimposition of rent regulation or control as being an important element of creating an environment of certainty and confidence. This is typically described as minimising the ‘political risk’ associated with private renting.

But, it could be argued that floating ideas around the change to Housing Benefit (discussed below) in itself injects another set of risks into landlordism. Moreover, these risks are more immediate and apparent than the somewhat vague ‘political risks’ that it is argued have inhibited the growth of the sector. Whether this is important in practice depends on whether it is the Housing Benefit sub-sector(s) of the private rented sector in which growth is felt desirable/necessary. This in turn raises the question of the types of individual or organisation that will be interested in catering for the ‘growth’ sub-sector(s). Implicit in the Green Paper discussion is the assumption that investors motivated by return on capital will, if they were to become involved in the private rented sector, wish to provide accommodation for the sub-sector(s) where growth is seen as desirable/necessary.

We know from existing research (esp. Crook et al, 1995; Crook and Kemp, 1999) that institutional investors are not interested in getting involved in landlordism on a small scale. The question then becomes how to get involved on a large scale. Two options present themselves. First, investors can either buy or provide loans to existing large organisations, and there appears to be limited enthusiasm for direct ownership. Second, they can postpone involvement until small organisations grow organically to become large enough to be a realistic investment proposition. The former option is made difficult by the fact that there are few large private property management companies. This suggests that the second option is the more plausible. The problem is that there has been very little thought about the process by which this desirable end-state is to be achieved. Most small landlords are happy staying small. Those that go for growth are unusual, entrepreneurial and can adopt relatively risky strategies. If the government has a desire to see large scale landlordism then there needs to be some thought to setting in place a framework and a pattern of incentives that will encourage growth, but not encourage or underwrite incautiously risky expansion strategies.

Encouraging greater involvement in private renting by private institutional investors has been a policy goal since at least 1980. It would be appropriate to ask whether, by focusing on the large institutional investor, policy is not perhaps looking in the wrong direction? The recent comparative work by Bramley et al (1999) suggests that in the countries they studied (USA, Australia, France and Germany) institutional investment was by no means a dominant feature of private landlordism. This is the case even though renting in these countries does not suffer from the image problems that it does in this country. Hence, in this respect at least the UK is not that far out of line. Is there something about the economic fundamentals or the

practicalities of private landlordism that means that it is not attractive to large investors? A further question is whether the presence of the City of London is a help or a hindrance if the goal is to increase institutional investment in private renting. On the one hand, the sophistication of the City means that it can pick up on promising investment opportunities that arise. On the other, the very sophistication of the system and the array of alternative investment vehicles that is available may make it harder to interest investors in private renting. One of the reasons for the decline of private renting during the twentieth century was the emergence of alternative outlets – such as building society accounts – for the small investor. These meant that money could be invested for a competitive return without the need to bother with the complexities of housing management. It is possible that we currently face an analogous situation with respect to large investors.

This isn't to argue that policy shouldn't be concerned with interesting large private investors in private renting. Rather it is to suggest that devoting all attention towards such investors may be misplaced. On the one hand, in most developed economies it is the small landlord that predominates. How small investors either individually or in concert can be encouraged to make long term investments in the sector remains an important question. On the other hand, it may be that there are alternative routes to large scale private landlordism. Registered social landlords are identified in the Green Paper as 'obvious candidates' for providing low cost management services to small landlords and the government will seek to open a dialogue on the possibilities (para 5.15). Might they not be the obvious candidates to offer large scale market renting also? Large RSLs could offer the possibility of developing a geographically diversified portfolio of market rented properties, have the necessary expertise, be of sufficient scale to offer a realistic proposition for attracting finance by private investors and have the 'back office' infrastructure in place to take advantage of economies of scale in administration. It might be the case that the 'front office' would be branded differently so that it does not appear to be 'social housing' and there would need to be some thought as to how such activities would link to core activities within the purview of Housing Corporation regulation. Nonetheless, it seems a route worth exploring further.

The use of Housing Benefit to improve standards

The Green Paper proposes some novel uses of Housing Benefit in pursuit of higher quality. It is justified in being cautious about a general proposal to make Housing Benefit conditional on the landlord providing a decent quality property and management (paras 5.39-5.40). But it raises a number of options for using Housing Benefit payments to influence standards. These are:

- To restrict Housing Benefit payments in respect of poor housing in areas where the market is over-supplied and claimants would have little difficulty finding a suitable alternative (para 5.41)
- To make direct payments to the landlord contingent upon the landlord meeting acceptable standards of provision and management (para 5.44)
- To make Housing Benefit payments contingent upon the tenant not engaging in anti-social behaviour (para 5.46-5.47)

I do not propose to consider all the dimensions of these proposals but it is necessary to examine the question of the incentives that they create and the behavioural responses that we might expect from landlords.

Before doing so it is worth noting that the first of the options does nothing ‘to address the problem of claimants living in unsatisfactory homes in areas of high demand’ (para 5.43). This seems an important omission. One could argue that if ‘claimants have little difficulty in finding alternative homes of a fit standard’ in a particular locality then there is little need for a scheme of the type proposed: tenants can effectively exercise the exit option to discipline landlords. This presupposes that the alternative better quality accommodation would be affordable and not fall foul of the Housing Benefit rules. An area in which the excess supply comprises poor quality accommodation is a separate issue, and one not addressed by the Green Paper. In contrast, it is in areas of excess demand, where alternative accommodation is hard to find, that raising the standard of the poor stock is more important because landlords can persist in providing poor accommodation with impunity.

Turning to the question of incentives and behavioural responses, the first option rests upon the view that landlords offering poor quality properties will allow a restriction in Housing Benefit to be translated into a reduction in the rent payable. It is necessary to think through how such a system might work. If a tenant takes up a tenancy and subsequently finds that Housing Benefit has been restricted – or even denied (para 5.42) – because the dwelling is of poor quality or the landlord unlicensed, what is the tenant to do? They have effectively committed themselves to a six month assured shorthold. If they leave before six months they are still liable for six months rent. It is presumably not the government’s intention to implement a policy integral to which is the tenant breaking their contractual agreement. This implies that they have to remain in the tenancy for at least six months and cover some or all of the rent from their own pocket. An alternative would be to compel landlords to declare themselves as having been excluded from or sanctioned by the Housing Benefit system before the tenant agrees to the take on a tenancy. This would mean the tenant could make an informed choice.

The LRC’s (1999) examination of the impact of the Single Room Rent and Local Reference Rents noted that landlords considered it the tenant’s responsibility to pay the rent. Tenants would be expected to make up the shortfall from their income or to borrow the money. Alternatively the landlord might take any shortfall from the tenant’s deposit at the end of the tenancy. This brings with it the possibility that the tenant would not be able to secure future private rented accommodation and consequently find him/herself homeless. This suggests that the government’s proposal for a third party deposit holding scheme (paras 5.16-5.17) is an important complement to any strategy involving restrictions in Housing Benefit.

The other possibility is that the shortfall in rent results in eviction (whether lawful or unlawful) and harassment. Shortfalls in rent have been identified as one of the most important causes of this type of landlord behaviour (Marsh et al, 2000). In sum, in pursuit of the bad landlord, this first option is likely to impose considerable costs upon tenants.

While the growth of direct payments of Housing Benefit to landlords may be seen as undesirable, we need to consider how landlords view such payments. If they see them as effectively reducing the risk attached to renting to tenants who depend on Housing Benefit then one might expect that removing rent direct could lead to upward pressure on rents in order to embody both a risk premium and additional administration costs. Alternatively, it may result in a reduction in supply to this segment of the market because the perceived risk of default, and consequent disrupted cash flow, is so great as to be unacceptable.

The third option – making Housing Benefit or the method of its payment contingent upon the tenant's good behaviour – will arguably have the same effect. There is a strong feeling among landlords – including the good ones – that they are property managers: they are not social workers or hand-holders for their tenants. Housing Benefit reclaims from the landlord because a tenant has failed to declare their circumstances accurately are considered to be iniquitous precisely because they are seen as penalising an innocent party. Landlords are also constrained by law regarding the extent to which they can intervene in their tenants' affairs without leaving themselves open to charges of harassment. Moreover, anti-social behaviour by tenants is a key trigger for unlawful eviction because it is felt that due process is too slow to deal with it effectively (Marsh et al, 2000). To expect landlords to supervise the 'rehabilitation' of tenants and to accept reduced rent in the process seems implausible. If landlords face the prospect of being penalised for the anti-social behaviour of tenants on Housing Benefit then many will either expect a considerable risk premium or exit the Housing Benefit market.

Voluntary regulation, self regulation and licensing

The Green Paper makes it clear that the government favours voluntary over statutory regulation and that licensing will largely be restricted to the HMO sub-sector. It also takes a positive view of the Law Commission's proposal that a new lease should carry with it the requirement that the dwelling be fit on first, and all subsequent, lettings.

Comprehensive licensing is ruled out as follows: 'Licensing the whole sector – over 10% of our entire housing stock – would be a massive undertaking which would risk collapsing under its own weight, not least as a great many homes enter and leave the private rented sector each year. The extra red tape involved would also be likely to encourage some perfectly respectable landlords to leave the business altogether and to dissuade others from joining it' (para 5.31). The Green Paper then proceeds to outline the case for limited licensing in particular localities.

There are three points that are worth making at this point. First, while the notion that a lease should carry with it the implication that the property is fit is no doubt welcome, the idea that this 'would provide tenants with a new opportunity to take action against delinquent landlords' (para 5.29) needs to be treated with caution. It may provide such an opportunity, but tenants' lack of knowledge of their rights and their perception of their precarious position with respect to security of tenure are likely to mean that many do not take up this opportunity: they will either simply move to another dwelling or, in areas of excess demand, stay put and put up with the problem. This is one of the messages that emerged strongly from the research on harassment and unlawful eviction (Marsh et al, 2000).

Second, also emerging from the harassment research was the view that local accreditation schemes and industry-led regulation, while potentially useful, can lack either the carrot or the stick needed to guarantee quality or encourage quality improvements. They are likely to be most effective where local market conditions mean that landlords can comply and still realise an adequate return on their investment. Some landlords who are part of local accreditation schemes were apparently ignorant of their legal obligations. Some of those in landlords' associations – who would most likely be considered "good and well-intentioned landlords" in the Green Paper's terms – admit to engaging in acts, often consciously, that were either of doubtful legality or were clearly unlawful. The government's better regulation guidelines may start with a preference for voluntary or self regulation, but it would perhaps be useful to

investigate more responsive and nuanced regulatory strategies as proposed by, for example, Ayres and Braithwaite (1992). Their 'benign big gun' model of regulation suggests that for voluntary and self-regulation to be effective it needs to be backed up with the threat that regulatory pressure will be increased and the process formalised if self-regulation does not deliver. That threat may rarely be invoked but it nonetheless focuses the minds of those being regulated.

Finally, it is difficult to see how licensing per se can be ruled out because the burden of 'red tape' and administration depends on the details of the system in place. Clearly some systems of frequent inspection and monitoring will place a burden upon landlords. Yet, it is possible to envisage a range of other systems, including those based largely on self-certification, with lower costs of compliance and administration.

For example, it would be possible to set up a system requiring all landlords to possess a license to operate, but that license is granted without the requirement for checks on the property or management standards for first time landlords. Hence, the presumption is that the landlord is well-intentioned. The license could be purchased periodically, like a TV license, from a Post Office or from the local authority (who would keep a record of licenses withdrawn/suspended). A landlord would require only one license to cover all their properties. A copy of the license could be required to be shown to tenants before they take up their tenancy and could be required as a component of all applications for Housing Benefit by any one of the landlord's tenants (which is similar to some of the Green Paper proposals). Alternatively, one could require a copy of the license to be submitted alongside the annual tax return. This would act as a counter to any landlord's claim that they did not know that they needed a license. (If a landlord had been renting property for more than a year then the only way they could not know about licensing would be if they were not declaring their rental income.)

A license would only be withdrawn or suspended if it becomes apparent that a landlord's properties are substandard or dangerous or if they engage in harassment or other unlawful behaviour. Clear guidance from central government would need to be issued to ensure that those charged with implementing the regime apply the rules equitably. As with driving, operating without a valid license would be an offence. If we consider that removing the option of landlordism is too severe a penalty, then it could be that the landlord who has his/her license withdrawn/suspended could retain ownership but would have to place the properties in the management of a professionally recognised agent, perhaps for a finite period. The landlord would then incur a financial penalty (the management fee) and tenants' quality of life would be improved. The thrust of such a system would be that as long as landlords lawfully provide an adequate service they would only incur a low cost. Such a system would be no more burdensome on the individual landlord than arranging for their car to be taxed or TV licensed.

The fact that at present even when convicted of unlawful behaviour a landlord cannot be disqualified from continuing as a landlord signals that undesirable behaviour in this field is not a serious issue. Some system that imposes a minimal burden on most landlords, but can effectively exclude the bad landlord seems essential if the government's goals for the sector are to be realised. Systems of voluntary or self regulation alone are not backed up with the necessary force.

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Key points from the discussion of the private rented sector

- Private investors want a 'level playing field', especially in tax terms. In particular pension funds wanted a form of investment which was tax-free, which was not possible if they invested via a property company rather than owning directly.
- Could quite radical measures be considered, including more general exemption of the PRS from tax? Were significant amounts actually being collected under current arrangements?
- Depreciation allowances were a further issue. Other countries with more active private rented sectors had these, for which there were logical grounds in any case.
- Social landlords could prove the route through which a larger private rented sector grew, for instance with market renting of some of their properties.
- There were dangers in making private renting too attractive in that this could fuel household growth and end up pushing poorer people into worse areas.
- Concentration on institutional investors has meant that we have ignored the potential of small investors with just a few properties – although such properties might quickly leave the market. There was a gap in the research base here.

3. Poor housing in the private sector: a response to the Housing Green Paper

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The Housing Green Paper deals with private sector housing conditions within the framework of sustainable home ownership (Chapter 4). It is good to see the government noting that repair and improvement costs are significant issues in relation to affordability and sustainability in the owner occupied sector. In particular the recognition of the repair and maintenance problems faced by some right to buy purchasers is long overdue.

By and large the Green Paper's proposals in relation to housing renewal policy are to be welcomed. They aim to deliver more local flexibility and freedom and to remove obstacles to new approaches which are designed to enable more private investment in repair and improvement. The main concern is whether a more radical set of changes are required. These comments recognise the value of the proposals which the Green Paper makes and make suggestions for taking these forward, but they also point out ways in which the government should be looking for a broader reform of the policy framework.

The Green Paper rightly points out that all those who buy have an obligation to ensure, as far as possible, that they take the costs of repair into account when assessing their own ability to buy. It also supports initiatives to educate and inform owners about repair costs. But it must also be recognised that some people may suffer unpredictable changes in their circumstances and these people will still need help. In addition, there is a very large group of low income home owners (including some older people and people who purchased under right to buy) who bought at a time when governments were less concerned to point out the need to plan for long term repair costs and more concerned to promote entry to home ownership irrespective of sustainability. It would be unacceptable to leave this group without assistance in meeting repair costs which they cannot afford.

Not all problems with housing conditions stem from resources, as the Paper points out. Fear of cowboy builders, poor workmanship and disruption are major factors. The Quality Mark initiative is a welcome response to this. Lessons from the pilots should be absorbed as soon as possible and the scheme should be rolled out to give nationwide coverage. But one problem with the scheme and with similar initiatives is that it does not do anything to increase the overall supply of competent builders. As well as applying tighter controls of the industry, there is a need for improved training to improve the supply of good builders. Without this, schemes to vet builders are simply fighting amongst themselves and many good builders do not join schemes because there is no need for them to do so. Training to improve the supply of builders needs to cover the skills required to run a business efficiently, and the skills needed to work with customers in their homes – service industry skills as much as construction skills. These are as important as technical skills in the small-scale domestic repair and maintenance sector. Although the industry could take responsibility for such improvement in the long term, it is likely, as with Quality Mark, that the government will need to kick start any improvements with encouragement and funding.

The Green Paper stresses the need to educate home owners about the need to keep up with repairs and maintenance and the benefits of practical initiatives (such as home improvement

agencies or Urban Care schemes). DETR has already funded research to evaluate these schemes and to commend them to local authorities. A welcome further boost to the funding for home improvement agencies was provided in the recent Comprehensive Spending Review. But progress in expanding general advice services like Urban Care has stalled, because of the revenue costs associated with these schemes. Information and advice cannot be self financing, and is rarely fee generating, but the balance of evidence is that it pays for itself in preventative terms by inducing additional expenditure by home owners from their own resources. The government should consider how it can help local authorities and other providers to expand the availability of Urban Care type schemes, for example by relaxing rules on funding mechanisms to allow the use of capital as well as revenue resources.

The proposal to produce an index of typical repair costs will be useful. No doubt there are many practical difficulties in doing this and many qualifications to the data, but the index will still be of general value to those who do wish to take a prudent forward planning approach to meeting repair costs. It will be as important to ensure that the data is regularly updated and widely disseminated as to get the figures right technically.

The Green Paper sets out two important aims in relation to public finance for private sector renewal. The first is to use these resources more strategically and effectively by allowing local authorities more scope to tailor policies and mechanisms to their own circumstances. This is a long overdue reform. Given the variations in housing conditions and in housing markets across the country, it is anomalous that a uniform framework of policies and instruments should be in use across all localities.

Secondly, local authorities and their partners are prevented from developing effective strategies by the restrictions on their freedom to act appropriately. The recent burst of interest in developing alternative sources of private funding to repair work has revealed the extent to which authorities are hamstrung by regulations and restrictions which sometimes defy all their ingenuity. It would be far better to enable authorities to be innovative and to develop local policies for which they could take responsibility. The measures which the paper suggests to give greater discretion on helping owners with repair and maintenance should be introduced as quickly as possible. Indeed the paper refers to more discretion over grants, but it would be better to give even more freedom by allowing other approaches to feeding public money into renovation – for example equity loans, repayable loans, revenue payments to meet loan debt charges, or subsidies to reduce loan set-up costs.

Despite these welcome proposals, which will give more flexibility and draw in more private resources to tackle disrepair, and its recognition that some owners will always need help with repair work, the Green Paper does not really address the question of who should receive help and the scope of that help. What is absent is a rationale to determine when public money will be made available and for what. Whilst this is politically difficult, it is an essential pre-requisite if owners are to be clear what their responsibilities are and what help they can expect to receive. This clarity is exactly what the present system lacks.

Realistically, if public resources are to be used more effectively and to help more people, whilst at the same time drawing in more private money, the role of state funding needs to change:

- We need a tighter rationale for public spending, probably focusing mainly on health and safety issues – to support work which endangers health for example.

- Although this may not offer long term value for money, work funded by public resources needs to be more orientated towards shorter term and lower cost solutions which enable more people to be helped – person rather than property-based solutions.
- Mechanisms may have to be less generous – repayable loans, equity loans, or grant on loan interest rather than capital grants. Options which enable resources to be recycled should be explored.
- As a last resort, it must be recognised that some owners cannot afford to sustain themselves as home owners without frequent inputs of state aid and in these cases it may be better to offer options which enable them to change into rented tenure – whilst staying put.

Most of these comments have focused on housing repair problems which stem largely from individual problems – the inability of low income home owners to afford repairs, or an unwillingness to tackle these problems for other reasons. Such problems are likely to increase as the population ages and as social relationships and employment become less stable. They are often scattered in their incidence. But there is increasing evidence that in some areas concentrations of poor housing are emerging – especially in the inner areas of northern and midlands cities. Poor conditions in these areas are compounded by problems of market failure and weak demand. Area-based housing renewal mechanisms (such as Housing Action Areas and more recently Renewal Areas) have been used to tackle these problems. Some Renewal Areas have been successful but, increasingly, local authorities are cautious about declaring them because there are no mechanisms to guarantee to necessary ten year resource streams which declarations imply.

The Green Paper proposes minor changes to the Renewal Area concept to make declaration more straightforward, but it is questionable whether this is the best approach. Evidence from areas where market failure is occurring in the private sector suggests that poor housing conditions are only part of a broader need for regeneration – and indeed they may not be the main priority for action. Dealing with crime, improving the environment, empowering the community, and creating jobs or reviving businesses are the important first steps. Where housing improvement is required, this is best undertaken within the framework of a wider regeneration initiative (such as SRB or New Deal) which can go further in offering the necessary level of resources for housing renovation over the required long term timescale. In other words area-based housing renewal would be better set in the context of broader regeneration policies than relying on the Renewal Area mechanism – which can deliver some housing investment but often lacks any broader regeneration programme.

Key points from the discussion of stock renewal

- The Green Paper had explored options other than grants, but it was hard to get the balance right on how much should go through loans.
- There was a fundamental issue about the level of help to low income owners with repair costs, by contrast with the help to tenants through Housing Benefit, which covers equivalent costs.
- Half of those on low incomes are owners, but their support has been marginalised as an issue.
- The move to a 'single capital pot' would allow local authorities more flexibility in supporting stock renewal. What will be interesting is what will be left for home owners after the size of the needs of the social sector is clarified through the new major repair allowance.
- The current system does not allocate the resources efficiently – i.e. it is done grant by grant rather than strategically.

4. Housing Benefit: Observations on the Housing Green Paper

Peter A Kemp, Department of Urban Studies, University of Glasgow

Introduction

The chapter dealing with Housing Benefit has been described as one of the ‘greenest’ parts of the Housing Green Paper. Although the Government admits it has “inherited a fragmented, confused and failing Housing Benefit system” (DETR and DSS, 2000, para 11.49), it is not always very clear what action or changes will be put in place to tackle these problems. The chapter is very tentative in tone and barely of sufficient colour to qualify as a ‘Green Paper’ in the traditionally accepted sense.

The Green Paper describes some of the initiatives that have already been introduced or are being developed, such as the use of remote access terminals and electronic transfer of documents. It also sets out some possible reforms that might help to simplify the scheme or otherwise improve administration, tackle fraud and improve work incentives. However, it is not clear which, if any, of these possible reforms are likely to be introduced. Indeed, the Green Paper stresses the risks and costs of such changes as much as it does the benefits that might result from them. Some fundamental reforms are discussed but the possibility of introducing any of them has been deferred for a decade until social housing rents have been re-structured.

In effect, the Housing Benefit chapter of the Green Paper is more of a discussion document than an outline of intentions. Perhaps that is as it should be, for it gives the various stakeholders, think tanks, academics, private individuals and others the opportunity to be consulted; presented with ideas for debate, rather than proposals set in concrete that are unlikely to be changed all that much. Widespread agreement about how Housing Benefit should be reformed is probably necessary in order to implement successful, lasting reforms to the scheme.

Problems with Housing Benefit

The Green Paper sets out a formidable list of problems that “we need to tackle in order to modernise welfare and housing” (DETR and DSS, 2000, para 11.5). In summary, these problems are:

- The delivery of Housing Benefit is complex, confusing and time consuming
- The benefit rules are [too] complex
- The performance of local authorities in administering the scheme is inconsistent
- The administrative hassle and delay can leave claimants with rent arrears or at risk of eviction
- Fraud and error in the Housing Benefit system costs an estimated £840m each year
- Housing Benefit can act as a barrier which deters people of working age from getting into jobs
- Landlords can exploit the system
- Housing Benefit takes away responsibility from claimants and gives them little interest in the rent

Solutions and dilemmas

In order to tackle these problems, the Green Paper describes a number of initiatives that the Government has already introduced, is developing or is in the process of introducing. Other possible reforms that might help to deal with these problems are also discussed. Most of the existing or possible reforms are likely to help ameliorate these problems, though none is without difficulties or risks. Such changes as the introduction of a single claims process, a national claim form, and greater information sharing between the different agencies involved in the administration of the scheme, could potentially help to improve the delivery of Housing Benefit.

However, these relatively modest changes are at best likely to make relatively modest (if worthwhile) improvements to the scheme. They are unlikely to transform the administration of Housing Benefit and substantially remove the problems outlined in the Green Paper. Although the scheme will be somewhat less complex as a result of changes such as these, it will still be very complex indeed.

And yet it is the very complexity of Housing Benefit that is at the heart of the deep-seated problems from which it suffers. While the *structure* of the scheme is relatively simple, the *administrative rules* surrounding the definition, identification and verification of the key variables – resources (income and capital), household composition, tenancy arrangements, and eligible rent – are highly complex.

The fact that benefit is re-calculated immediately that claimants' report a change of circumstances (even where the change is relatively minor) further complicates administration. As the labour market moves towards more 'flexible' employment, tenants are likely to experience much more frequent changes of circumstances, in contrast to the more stable forms of employment in the past. These new circumstances raise doubts about whether it is sustainable to operate a Housing Benefit scheme that is so finely tuned that even quite small changes of circumstances have to be reported and benefit entitlement re-calculated.

Fixing Housing Benefit awards for set periods of six months (subject to the right for claimants to request a review) could help to streamline administration and remove some of the work disincentive effects of the scheme (Kemp, 1998). This idea appears to have wide support, as the evidence submitted to the House of Commons Social Security Committee's Inquiry into Housing Benefit makes clear (Social Security Committee, 2000; see also Hills, 2000).

In the longer term, there may be a case for taking a more broad-brush approach to the rules governing Housing Benefit and the other main means-tested benefits. This might involve, for example, taking a more simplified approach to the definition of income. However, an important reason why entitlement to benefits is so finely calibrated and adjusted in Britain is because the levels of basic income support benefits (other than Housing Benefit) are relatively low. To some extent, complexity enables Housing Benefit entitlement to be adjusted to the precise financial needs of people on very low incomes. A more broad-brush approach would create financial hardship unless accompanied by more generous benefit levels. In other words, simplifying the scheme in a way that did not cause undue hardship would cost a considerable sum of money.

This dilemma also applies in reduced form to more minor simplifications such as the fixed period awards mentioned above. Setting Housing Benefit awards for fixed periods would improve the administration of the scheme. But it would almost certainly increase the cost of the scheme and could create hardship in some cases, neither of which is appealing to the Government. The result is that simplification of Housing Benefit is to an extent caught between a rock and a hard place. Securing substantial improvements in the administration of Housing Benefit will require simplification, but that it turn will either cost money or create hardship among people who are by definition already living on a low income.

Fundamental reform

The discussion in the Green Paper about fundamental reform of Housing Benefit centres mainly on the idea of replacing it with a flat-rate housing allowance as an addition to basic benefit levels. It would vary by household type and perhaps by area, but take no account of tenants' actual housing costs. Such a scheme would be inefficient, paying too much benefit to some households and not enough to others and therefore "does not look at attractive option" (para 11.70).

In contrast to the space devoted to this 'unattractive' option, only three sentences are given over to a reform that apparently strikes "a better balance between the risks and gains" (para 11.71). This option would involve tenants making a modest contribution to their rent, with benefit levels (and applicable amounts in the case of people not receiving income support benefits) being raised in order to allow them to afford it. Only a paragraph is devoted to the idea of a housing tax credit (see Wilcox, 1998) and none at all to an innovative scheme recently suggested by John Hills (2000).

Perhaps the discussion focused on the unattractive option in order to convince readers of the inadvisability of introducing reforms that give tenants a financial interest in their rent? Either way, fundamental reform has been ruled out until social housing rents have been re-structured and allocation policies have been made more flexible. Certainly, it makes little sense to give social tenants a financial stake in their rent under the present largely incoherent rent regimes and relatively inflexible allocation and transfer systems. However, that does not mean that reform to Housing Benefit could not or should not be introduced for private tenants.

The fact that Housing Benefit gives tenants little interest in their rent is a more serious problem in the private rented sector than in social housing because rents there are set by the interaction of supply and demand. There is a potential moral hazard problem of private landlords or tenants taking advantage of the fact that Housing Benefit can cover all of the rent and all of any increase in rent (and reduces in full for any decrease in rent). This has led to the introduction of a complex array of rent restrictions for claimants with private, deregulated tenancies.

These numerous restrictions on 'unreasonable' rents complicate the administration of the scheme, making it more difficult and time-consuming for officials to administer and much harder for claimants to understand. They also result in hundreds of thousands of private tenants facing a shortfall between their contractual rent and that which local authorities will take into account for Housing Benefit purposes, which can cause financial hardship (see Kemp and McLaverty, 1995; Kemp and Rugg, 1998; London Research Centre, 1999). These shortfalls are not just the result of the local limits for benefit recipients (the local reference rent and single room rent). They are also the result the other rent restrictions, such as those

imposed where the rent is deemed to be over the market value or the accommodation is considered to be overlarge for the claimant's needs.

An alternative, simpler and more transparent way of solving the moral hazard problem would therefore be in the interests of private tenants, administrators and private landlords alike. Re-designing the scheme so that it includes a modest 'shopping incentive' for private tenants could potentially provide that alternative, so long as it is designed in a way that does not create a shortfall for tenants whose rent is not unreasonably high (see Kemp, 1998; 2000a).

However, the imperative to avoid serious losses for significant numbers of tenants means that it would cost money to introduce a modest shopping incentive such as this; it could not be done at nil-cost. But as someone (I forget who) once pointed out, the only no-loser, nil-cost reform is the status quo. And the status quo is often delays in the processing of claims and shortfalls arising from rent restrictions, both of which cause difficulties for private tenants and their landlords.

Conclusion

The problems from which Housing Benefit suffers are deep-seated and will not be easily resolved. The fact that the scheme interacts with the rest of the social security system, income taxation, and housing finance; and involves a variety of stakeholders – including low-income tenants, local authorities, landlords, mortgage lenders, and at least three government departments (DSS, DETR and HM Treasury) – only adds to the difficulty of reforming the scheme (Kemp, 2000b). Nevertheless, the problems are so serious that something urgent needs to be done to tackle the problems outlined in the Housing Green Paper.

Many of the limited or nil cost changes mentioned in the Green Paper could make a real difference, but perhaps not a sufficient difference to transform the delivery of this benefit to the four million low-income tenants who rely on it to pay their rent. Making a substantial difference may require additional resources to be spent in order to introduce even small changes such as setting benefit awards for a fixed period. It remains to be seen just how willing or otherwise the Government is to meet this bill or whether Housing Benefit can really be reformed at little extra cost.

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Key points from the discussion of Housing Benefit

- We have to think through why the Housing Benefit reform debate had gone round and round in circles. Fundamentally the problems reflected the lack of generosity of other benefits like Income Support, so help had to be closely tailored to actual costs.
- The long-run outcome could be the creation of some kind of more general housing allowance, of a fixed size, as part of anti-poverty policy. This could float more people off HB altogether, as the WFTC has done.
- Policy may become differentiated by age-group, for instance with a different kind of system run through the new working age agency.
- Although some could be floated off by more generous tax credits, the majority of HB recipients were still long-term Income Support cases.
- It was suggested that the Green Paper was very weak on even modest short-run reforms, such as allowing benefit to be fixed for a period, like the six months in WFTC. This year HB was costing £1.5 billion *less* than initial spending plans: this should have given the scope to think more radically.
- While the Government had decided to go first for rent restructuring, this did not mean that HB reform was off the agenda for the ten years this would take.

5. Large Scale Voluntary Transfer and Arms-Length Management Companies

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1. The Green Paper Chapter 7 essentially takes as its starting point that ‘public investment is not enough’ (para 7.8) to secure the improvements that Central Government is seeking. In this note this will be taken as given and hence I won’t raise issues regarding:
 - the ‘appropriate’ level of public expenditure in aggregate
 - the priority given to housing relative to other expenditure within that aggregate
2. However, even if the level of public investment was enough the Green Paper indicates that ‘Simply spending money...is not enough’ (para 7.4) to ensure:
 - an increase in the effectiveness of housing investment
 - improved management of housing
 - expanded tenant participation
3. There is a need for a different organisational and financial framework to deliver this. Will LSVT policy and proposed Arms Length Management Companies (ALMC) prove to be the institutional forms that will deliver? First, consider LSVT.
4. The advantage of LSVT is that it operates outside public expenditure regime – therefore access to potentially greater investment funds raised on market (therefore efficient?) basis.

Will private investment be increased by LSVT?

5. Evidence to date:
 - By definition it has happened otherwise transfers would not have occurred
 - Improvements and refurbishment of the stock have happened in the smaller stocks of housing transferred to date
6. Will this continue? It will be facilitated by Green Paper commitment on overhanging debt. But does this bring with it the need for DETR intervention? Otherwise, there is the issue of LA -RSL negotiations over sale value. What are the incentives for local authorities regarding negotiating the best price for the stock?
7. There are practical issues in larger transfers, such as construction industry’s capacity for stock improvements. As an illustration:
 - The Coventry LSVT and Orbit HA’s (Midlands Region) reaction – both going for longer term partnering. Reduce costs of tendering/contracting at increasing ‘spot’ market prices due to volume of improvement activity.
 - Transferring the DLO? In-house capacity – but don’t normally carry out refurbishment: also associated with previous landlord’s failure to maintain property efficiently.

Will private investment continue to be attracted to LSVTs?

8. Attraction to private investors of financing the purchase and improvement of stock:
 - Purchase is at Tenanted Market Value – Present Value of predicted rent income (under current rules) net of expenditure on repairs and maintenance @ 7% over 30 years
 - Lenders' Valuation is Present Value of rent stream of stock given increased stock value (and hence rents) through improvements, increased re-let rents and rent increases outside of the guarantee period supported by HB
 - Lender's ability to take over the stock in case of default, replace management, sell vacant units (subject to Secretary of State's permission) and rent streams supported by HB
 - Risks further mitigated by cover and through interest premium. So: $LV > TMV$
 - Do Lenders want 'control rights' (Board membership) as well? Currently they aren't allowed to – a condition of registration as RSL: don't seem to want it anyway.
9. Will there be a long/short run limit to the supply of funds?
 - No sign so far – global players or at least players with access to global markets, but it is a function of the relative attraction of investment, phasing of LSVTs, and the quality of larger urban stock coming through
 - Impact of policy on future of rent increases under HB reform and RPI + 0
10. In this decision HB is crucial as it secures the rent stream from 70% tenants. No plans for change to HB structure, so not a real problem yet?
11. On the imposition of RPI+0:
 - previous/current LSVTs are expected to honour commitments to tenants. The Green Paper indicates that the government expects to see rent restructuring over 10 years – no explicit mention of convergence.
 - new LSVTs are expected to have rent restructuring and convergence over 10 years built into their business plans. Effects on rent stream, valuation and attractiveness to lenders? What if after rent guarantee period LSVT rent < other landlords? RPI+0 or RPI+2%? There is uncertainty here.

Will the quality of management be improved by LSVT?

12. Moving from 'monopoly suppliers...to a greater number of smaller bodies that are based in or closer to the communities where the homes are transferred' (para 7.14). As an example, does the Coventry LSVT constitute 'a greater number of smaller bodies'?
 - Post-transfer there are two organisations in a group structure under 'Services Board' and Joint Finance Committee. Green Paper accepts this type of organisation as an initial form but must have 'Capacity to change and split apart' (para 7.25).

- The ‘dangers’ of competition – competing on what in future? Funds, priorities for improvement? RSLs under group structure may have significant differences in stock quality, improvement programmes and ability to service debt.
13. TUPE and the transfer of culture – are new LSVTs that different in organisational outlook from the old ‘monopoly suppliers’?
 14. Bidding for LSVT stock to increase competition. How will this be packaged? Will there be regulations to avoid monopoly or favouring local authority bidder while maintaining viability of the tranches transferred?
 15. Are RSLs better managers (‘technically’) than local authorities?
 - The performance of the RSL sector has declined in recent years. LSVTs over-represented among low management costs RSLs. There are many reasons, but does it imply that local authority management not (relatively) that inefficient?
 - Are RSLs better equipped to deliver on regeneration, urban renaissance and partnership working?
 16. Can RSLs be held more accountable for their activities than local authorities?
 - Accountable to whom? Tenants’ voice increased.
 - Housing Corporation regulation versus DETR Housing BV Framework to maintain/ensure efficiency and effectiveness? The latter framework is powerful – the former ??
 17. Why regulate LSVTs anyway if they are not spending taxpayers’ money?

The role of ALMCs

18. The incentive for the local authority to create an ALMC are:
 - Retains significant control over its stock while concentrating on strategic function
 - Retain more of rental income for investment in housing improvements
19. ALMC is a necessary condition for retaining this income as is:
 - High score on BVH Indicators and ‘Excellence’ rating in BV Housing Inspection
 - Sound financial planning and long term viability through high quality business plan
20. So are the circumstances under which an ALMC can be created those in which the local authority is an excellent housing provider whose tenants have voted against (or at least not – yet – voted for) transfer? Are these the ones we should be worrying about, in terms of effecting performance improvements?
21. Can/should ALMCs be seen as the equivalent of a DLO under CCT? What will be the contractual basis for ALMC? This raises a range of principal-agent issues around, for example, monitoring and the compatibility of objective functions.

Key points arising from discussion on transfers

- Arms-length management companies (ALMCs) will be free of borrowing control so they can borrow privately, even though they will remain within the PSBR. While aggregate totals may be fixed, they will be outside of borrowing controls at the local level.
- The ALMC option should lead local authorities to rethink stock transfer as a strategy but it depends on the budgets available (both for ALMCs and transfer) under the Comprehensive Spending Review whether ALMCs are a realistic option for many.
- Depending on the success of ALMCs the Treasury may over time adopt a more relaxed view of trading activities by local authorities.
- In the short term there is likely to be a hiatus in the transfer programme while there is uncertainty about rent restructuring and hence business planning.
- Even though some local authorities may be doing as good a job as HAs or ALMCs could do, it may be that in reality rebranding through transfer to another landlord is likely to be the most effective way to reduce stigma and regenerate areas.
- The major transfer of the Glasgow housing stock is likely to happen, even though there is local opposition. If it doesn't then most likely the whole of Scottish housing policy will be thrown into question.
- There are two elements to competition in the transfer process. The first is post-transfer competition between landlords to attract and retain tenants. The second, less well developed, element is competition to take on the stock in the first place. This second dimension is a potentially important element of the picture.
- Do ALMCs represent a 'false hope' allowing local authorities to forget about the transfer option and take the view that they can stay as they are and borrow privately?
- Is the ALMC model sustainable? Is it possible/wise that they are free to borrow yet it counts against public spending? The incentives within this seem undesirable.
- Chapter 7 of the Green Paper is trying to make the point that it isn't just resources but how you use them that is important. By presenting options it is asking local authorities to grapple with the question of how best to act.

6. Reforming social housing rents¹

Steve Wilcox, Centre for Housing Policy, University of York

The 1999 Budget announced a planned housing green paper, with bold proposals to radically restructure both rents in the council and housing association (RSL) sectors, and the structure of the UK wide housing benefit scheme. Thirteen months later the green paper that emerged was far wider in its scope, and duly set out outline proposals for radical rent reforms, but somewhere along the line the ambition to reform the housing benefit scheme has been lost. This article will outline and critically review the green paper proposals on rent reform.

All change on rents

The Green Paper sets out three main options for rent policy in the council and RSL sectors, all of which are based to some extent on capital values, and would operate within a common context. The policies would apply to both councils and RSLs, and, in principle, would see all social landlords charging more or less the same levels of rents for similar properties. The reforms should bring some order to the current relatively chaotic patterns of rents in the two sectors, where there are systematic differences in the national policies for each sector, amplified by the varying decisions of individual landlords, both about their aggregate rent levels, and about how they set the profile of rents across their stock of dwellings.

Putting council and RSL rents on a common footing will involve ‘a measure of convergence’ between the two sectors, which means that in most parts of the country RSL rents will have to fall relative to council rents. To that end the green paper proposes that, from April 2002, average rents in the RSL sector should rise in line with RPI, rather than the RPI plus one policy that has operated over the last few years. Meanwhile average council rents are proposed at the rate of RPI plus 2%. How long this differential rates of increase will apply to the two sectors is not made clear in the green paper, partly because the extent of convergence required will depend on the final decision on the rent policy to be adopted, and how it is to be implemented.

At the same time it is not proposed to return to a system of direct regulation of rents, as under the fair rent regime, but rather to leave the responsibility for setting rents on individual dwellings with each landlord, but within the context of a financial and regulatory regimes that should see a far greater consistency in local rents levels across both council and RSL landlords. This is an ambitious project, but there are many detailed questions still to be resolved about how the new rent policies will be implemented in practice, in which the decision about which of the three ‘preferred’ rent policies is to be adopted is only one small part. Moreover whichever rent policy is adopted there will be profound implications for the future prospects of individual RSLs.

Current rent regimes

The current lack of a coherent rent policy for the council and RSL sectors was examined in detail in the 1997/98 edition of the *Review* (1). One of the key underlying differences in policy over the last decade is that while council rents have been linked to capital values,

¹ This paper is an extract from a version of an article entitled “Contrasting Ambitions” that will appear in the *Housing Finance Review*, August 2000.

through the rent policy embedded in the housing subsidy system, RSL rents have been linked to earnings, through the formula embedded in the Housing Corporation's grant rate model. As a result of this discrepancy north-south rent differentials in the council sector have widened over the last decade, while RSL rent differentials have narrowed.

The differentials in council rents grew rapidly in the early years on the 1990s, and have subsequently eased back. This is primarily because initially the subsidy rent guidelines were based exclusively on capital values, while since the mid 1990s they have been based 50% on capital values, and 50% on earnings. However, it is also partly because differentials in north south capital values eased back during the course of the 1990s, reversing the excesses of the late 1980s housing market boom.

Three policy options

The current rent formula in the council housing subsidy system thus provides the basis for one of the three main rent policy options set out in the Green Paper. A second option is to reduce the element of rents based on capital values to 30%, and increase the element based on earnings to 70%. The third option is based on capital values and 'running costs'.

Papers published by DETR following the Green Paper have thrown a little more light on the potential implications of the options for rent reform put forward in the Green Paper (2). One is a summary of the initial work that HACAS undertook for DETR exemplifying the potential impact of a much wider range of rent policy options for RSLs. Another is a DETR guide for RSL and council landlords, to allow them to calculate the sort of rents that the three Green Paper rent options might mean in practice. One key point is that for most RSLs the rent restructuring proposals will have a far greater impact than the annual RPI formula; and that their future viability will depend on the interaction between the different components of the new rent policy framework, rather than any individual factor.

The new rent policies will have a less dramatic impact on councils, given that their subsidy formula is already linked in part to capital values. The greatest impact is likely to be on those councils with rents that are substantially higher than the current subsidy guidelines, primarily as a result of past decisions to fund additional investment directly from rents. The housing subsidy system will also provide a cushion to allow councils to adjust to the requirements of the new rent policies. If rent guidelines go up, there will be an offsetting reduction in subsidy; if rent guidelines go down there will be an offsetting increase.

The three main rent policy options involve an element related to capital values, and an element related to either earnings or running costs. Two options are based on a combination of earnings (70% or 50%) and capital values (30% or 50%), with one option based on a combination of capital values and running costs, in which the running costs element is expected, on average, to account for just under a half of average rents in the RSL sector.

Devil in the detail

If both the DETR and HACAS papers will inform the debates about rent policy issues during the Green Paper consultation period, they also reveal the shortcomings of our current knowledge about the capital values of dwellings in the council and RSL sectors. There are also many practical steps still to be resolved about how the preferred rent policy option is to be implemented, and the decisions on those implementation issues will be just as significant

for many social landlords as the ‘in principle’ decision between the three rent policy options favoured by the Green Paper.

A central limitation in working through the implications of rent policies based on capital values is the absence of a consistent local level data set on the vacant possession capital values of stock in the RSL sector. The DETR guidance is based on 1999 valuations of the sample of council and RSL dwellings that were covered by the 1996 English House Condition Survey, from which the DETR derive formulae that can be applied to the stock of individual councils or RSLs. While the DETR guidance is extremely helpful the constraints of the limited size of the national sample of RSL valuations should be recognized, together with the need for RSLs to have appropriately defined capital values at current values to apply the DETR formulae.

The HACAS modelling for DETR used Halifax house price data for dwellings at the bottom end of the owner occupied sector to create an index of locational variations in capital values by local authority area. However the initial local level HACAS analyses of capital value rents covered by the published DETR summary all generated far sharper north-south variations in values than those reflected in the EHCS valuations of RSL stock. Consequently subsequent HACAS analyses damped the local level Halifax capital value data so that when applied to the RSL stock it generated north-south variations more consistent with the EHCS valuations.

Using damped capital values data the HACAS report also shows the potential impact of the three Green Paper rent policy options in redistributing average RSL rents between regions (at 1998 levels). In all three cases this shows rents rising in London, and reducing in the East Midlands and the northern regions. The extent of the rises reflect, however, not just the relative weighting attached to capital values in the three policy options, but also the approach taken to modelling earnings and running costs.

For example, while the HACAS modelling uses county level earnings data, the DETR guidance is based on regional earnings data, and while the HACAS modelling uses earnings data for low earnings across all sectors of the labour market, the DETR guidance uses average manual earnings data. Similarly while the HACAS modelling applies a flat rate running costs component nationally, the DETR guidance is based on formulae used in the local authority housing subsidy system, that differentiates between dwellings of different types and sizes, and applies weightings for regional cost factors.

Thus while the regional rent changes under the ‘running costs’ option would be lower this is largely as a result of the flat rate assumption on running costs. If a regionally disaggregated approach on running costs were to be adopted the impact on average regional rent differentials would be more like those resulting from the ‘50:50’ capital values and earnings policy option.

Many northern RSLs are likely to favour a rent policy options that gives as little as possible emphasis to capital values, and has the least on the current structure of RSL rents. There are, however, two points that should consider before committing themselves to that approach. The first is that one of the major problems for many RSLs operating in the north is that their rents are very close to market levels, and this makes it difficult for them to either attract or retain economically active tenant households (3).

The other factor is the link between the degree of convergence required between RSL and council rents, and the degree of emphasis on capital values in the chosen rent policy. For England as a whole the average capital value of RSL dwellings is some 20% higher than that for council dwellings. This is *not* because RSL dwellings are on average better quality than council dwellings – differences in quality have only a very limited impact on capital values. It is because more RSL dwellings are located in the south of England, not least because of the impact of stock transfers, in locations that have higher capital values. It follows from this that the greater emphasis on capital values in the adopted rent policy, the lower will be the extent of the convergence required between average rents in the two sectors, and the shorter the period that average annual RSL rent increases will be pegged to RPI.

Related issues

It will therefore be critically important not just which rent policy option is chosen in principle, and how large a component is formed by capital values, but how earnings or running costs are defined in practice. Other important issues to be resolved relate to the definition of rents, and, to quote from the DETR guidance – ‘the degree of flexibility for social landlords to set rents for individual properties within a restructured framework’.

While the DETR guidance is based on net rents, the HACAS modelling is based on RSL rents inclusive of service charges eligible for housing benefit. Part of the problem here is the lack of consistency between RSLs on whether they include components of costs, such as maintenance of common parts and grounds, as part of the net rent, or as a service charge. Current Housing Corporation rent monitoring is based on rents inclusive of service charges eligible for housing benefit, not least because if monitoring focused only on net rents this would be an open invitation to all RSLs to switch a range of costs to service charges.

For RSLs with a substantial proportion of self contained supported and sheltered accommodation the rent definitions applied have an even greater significance, although this definitional point should become less of an issue once the new financial regime for support costs has been introduced. What will be far more important for those RSLs will be the combined impact of rent restructuring and the new financial regime for support costs over the same period of time.

The issue of the ‘degree of flexibility’ for individual landlords is also important. Currently the Housing Corporation focuses its concerns on RSLs whose rents are more than 5% above local averages for the sector. If a similar degree of flexibility is permitted under the new regime it will significantly ease the process of adjustment for RSLs, relative to a policy requiring a greater measure of conformity.

A final element in the rent policy proposals set out in the green paper is that, for individual tenants, and rent increases or decreases related to restructuring will be limited to £2 per week each year. While it appears from the green paper that these phasing limits would apply after taking account of annual RPI increases, the details of how this element of policy is to be operationalised also remains to be determined. For most RSLs these phasing limits would see compliance with the new rent policies achieved within a ten year period, and in many cases over a far shorter period. The bigger question for many RSLs is whether they can comply with the new rent policy requirements, at the same time as remaining viable, and complying with the requirements of private funders.

There are important debates to conclude about the moves towards a more coherent rent policy for the council and RSL sectors. These raise particularly acute issues for the RSL sector, because they are being asked to adjust to the new regime without the 'financial parachute' that the housing subsidy system provides to the councils that will be required to reduce their rents under the new policy framework. If, however, those debates are to be fully informed there needs to be just as much emphasis on data, definitions and implementation, as on first principles.

References

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- 2 Impact and implications of restructuring rents in the registered social landlord sector, Summary, HACAS, DETR May 2000; Calculating prospective rents according to the formulae outlined in the Housing Green Paper, May 2000.
- 3 Social housing rent differentials and processes of social exclusion, J Ford, R Burrows, S Wilcox, I Cole and C Beatty, Centre for Housing Policy, University of York, 1998.

7. Subsidy Implications of the Green Paper

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The way in which subsidies would have to be adapted to meet the Government's aims, particularly for rents, is something of a missing chapter in the Green Paper. This is particularly important given the limits of what existing instruments can achieve.

At the most straightforward end there are three areas which can be achieved:

- For local authority HRAs *as a whole*, DETR can simply substitute any new rent system for the existing rent guidelines, and HRA subsidy will adjust.
- For *transfers*, new rent guidelines can be built into the transfer terms, so the new landlord can move towards a consistent level.
- For *new* housing association developments, capital grants can be set to be compatible with the same structure.

A rather harder issue is how such rent guidelines will relate to the current system of rent caps for local authorities. Will they be consistent but higher, giving authorities some discretion, or will they be the same, so that the guideline becomes an upper limit too? Another issue which is unclear at the moment is how rent caps will be achieved once rent rebate subsidy is taken out of the system.

What becomes harder is how the rent system will relate to housing association rent caps, and how associations will be compensated if the rent guideline is below the existing rent, and the income generated does not cover 'reasonable' costs. This gives a choice between:

- a) A capital buyout – in effect retrospective social housing grant.
- b) Future recurrent subsidies. But if so, how would they be calculated, and would this defeat the object of another part of policy, to get social landlords to be financially independent?

It should be noted that if the rent option chosen is *not* related to running costs, it becomes almost inevitable that there has to be some kind of recurrent subsidy/claw-back as incomes can then easily diverge from costs. A further key issue is obviously how 'surpluses' can be removed (if they can) from associations with rent guidelines above current rents. It is not clear how this can be achieved with current instruments.

All of this relates to rent guidelines at the level of the whole landlord. However, in several places the Green Paper talks as if the Government's intention is to set *individual* rents. Is this really the case? If so how can this be achieved – persuasion, inspection, or penalties? More generally if policy intends to achieve particular rents, this implies an end to the general idea that, while subsidy could support target rents, rents in practice would vary up and down depending on landlord efficiency.

There are some other wider unanswered subsidy issues in the Green Paper. Three worth considering in more detail are:

- *Arms length management companies.* The conditions set for these imply that these will depend on quality of management, not subsidy position. However, if they are still receiving *variable* HRA subsidy it is hard to see how they can really be at 'arms length' if, for instance, new borrowing increases capital subsidy entitlement. To avoid this they could have their capital finances restructured (as in a transfer) or remain entitled to a fixed flow of future subsidy.
- *Wider activities.* Debate is moving towards the advantages of social landlords diversifying in some areas to create more mixed communities, for instance through market renting or equity sharing of existing stocks. This could generate resources for buying property elsewhere or for catch-up repairs. However, the subsidy implications need to be thought through carefully – for instance to avoid this simply relaxing efficiency pressures.
- *Cost formulae.* If policy does move towards tighter constraints on rents, even at an individual level, the way costs are allowed for will become even more important. Compared with the NHS, the evidence base for calculating what management and maintenance allowances should be is very weak. One implication of the Green Paper may be that more refinement is needed of such allowances.

Key points from the discussion on social housing rents and subsidies

- While it is possible to read the Green Paper as indicating that the policy will be concerned with setting the rents of individual properties, it is average rents that are the primary interest.
- There are limited levers available to ensure that the government's objectives with respect to rent restructuring are realised. The HIP system offers some levers to encourage LAs, but these will be reduced with the move to a single capital pot.
- Government can move money around the subsidy system to protect those in some parts of the country but in high capital value areas authorities are recognising that they may lose if they stay as LAs. But if they transfer to the RSL sector then any rent surpluses generated are more difficult to claw back.
- Are ALMCs an irrelevance? They are seen as a starting point and in the longer term, if current plans to restructure capital financing come to fruition, then ALMCs will be in a relatively strong position.
- How with the financial system work with respect to ALMCs? In the short term there will be an extra element added to the authorities' subsidy calculation to allow them to borrow privately.
- It is recognised that while the new rent systems will not be about setting the rents on individual dwellings it will effectively break the rent-efficiency trade-off.
- There have been suggestions that the RPI+1% formula for RSL rent increases will be reinstated once convergence has occurred. But if RPI+0 is seen as part of a broader efficiency agenda then this is unlikely to be the case.

- If we work with any system of rent caps and allowances for management costs then it is clear that the less efficient RSLs will struggle. The question is how to deal with this. The Housing Corporation has a monitoring and cajoling role and it is already showing the how it could run the rent regime. Those RSLs that genuinely cannot live with the RPI+1% or RPI+0 will be allowed to set rents outside that constraint, but only after a thorough going over by the Housing Corporation.
- RSL viability is a knotty problem which seems to be driving the whole system. Is the right starting point from which to establish an appropriate system?
- Current LA rent structures make sense regionally and RSL structures make sense locally, but will moving to any of the new rent options give you the worst of both worlds? Current LA structures are steeper than those that would be generated by any of the options in the Green Paper. They mainly embody differentials between large and small dwellings which mean that they are coherent within the stock, but don't include location. Most fundamentally, are we sure that capital values are the right basis for social rent setting?
- The issue of including location in rent is the most contentious. Some authorities do not want to see location as a factor in their rents, but are keen that rents differ between estates!! It is clear that a capital value based system in boroughs with very different local housing sub-markets can generate 1 bed properties at one end of the borough with higher rents than 4 bed properties at the other. This must raise questions about sustainable communities and the conflict between rent policy and policies around mixed communities. In this debate it is important to ensure that objectives link across between the Urban White Paper and the Housing Green Paper. There are a range of possible options and all involve some form of damping, but how far do you go down the 'people should pay for what they receive' route before you create ghettos? Alternatively, should social tenants live in Mayfair? It's an old question, but one that remains unresolved.
- Given the multiple goals of social housing, is a single spine running through rent policy possible? Can a single system deliver regional and local equity, market-like incentives and mixed, sustainable communities?
- Whichever rent setting options was selected there is likely to be 'a good chunk' of local discretion within the system.

8. Concluding discussion

The following points were made during the concluding discussion:

- The Green Paper is perhaps not fully comprehensive but it attempts to pull everything together in one document and exhibit joined up thinking. It does not have all the answers and is willing to acknowledge the problems – this is one of its strengths.
- In the 1980s there were a string of high profile initiatives and less scope to think more broadly. The Green Paper is seen as part of the broader thinking that is now possible.
- For a while it has been clear that there is no ‘national’ housing policy – the low demand issue illustrates that – so how are policy makers going to cope?
- The Green Paper indicates that local authorities continue to have a role in the housing system which is perhaps contrary to what some had anticipated. While that role is primarily strategic, it does not mean that there isn’t a need for social housing.
- On some topics – such as the reform of Housing Benefit – there was some disappointment at the timidity of proposed change. The government could have tried harder.
- In the private rented sector the Green Paper perhaps focuses too much upon the large landlords/investors and forgets the small.
- More broadly, when thinking about the future of the owner occupied sector it is perhaps more important to think in terms of access to decent quality homes and choices about where to live, rather than simply about tenure.
- It is imperative that the government recognises that existing proposals for low income home ownership are fundamentally flawed and inadequate (see discussion in section 1 above).