Reflections on a Review of International and UK Perspectives on the Innovative Financing of Affordable Housing for the Joseph Rowntree Foundation

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Introduction
This paper is a reflection on the findings of research by the authors to the Joseph Rowntree Foundation reviewing a limited set of innovative models or policies geared to financing affordable housing. Language is important in this policy area and we note the importance of clarifying a number of key words:

- **Innovative** – this term may mean new to the UK context; indeed some of the models we investigate are quite old in their own national context. Models may also be innovative in the sense they are being tried in one part of the UK but not in others.
- **Models or policies** – we have tried to steer away from experimental projects and pilots and focus more on larger scale (or scalable) policies and models, reflecting our criteria assessing policies (discussed further below).
- **Affordable** – this is of course a linguistic minefield, increasingly so in an international context: do we mean social rent levels, intermediate/midmarket or affordable or near market. In different parts of the world and at different times, the position on the spectrum of possibilities below market offers is highly malleable. In this context we also note the methodological problems of conducting comparative analysis and seeking policy transfer lessons (Dolowitz and Marsh, 2000; Stephens, 2011).
- **Financing** – we are primarily interested in novel ways of raising funds cheaply for the expansion of affordable housing supply but also reducing the ultimate payment burden on consumers in sustainable ways.

The review takes place in a context of economic recession, fiscal austerity and severe credit constraints impacting on all parts of the housing system. This is happening while poverty, inequality and lack of access to decent housing is rising inexorably.

Review
Our aim was to critically review the international and UK evidence (i.e. across the four devolved nations) on ways of financing low cost housing across all tenures. The study asks which models have the potential to produce the most housing in the short, medium and long term? What reforms would be necessary to adapt the most promising international/UK approaches and to also assess which models require further testing or development? The project combined desk-based review, the application of researcher specific knowledge of countries and systems, plus specific
advice and support from consultants and in-country colleagues. The project team also held a special project seminar in Edinburgh in June 2012.

The study reviewed the housing background in the UK before assessing the existing literature and found a number of important academic, policy and expert papers (e.g. research by Clarke (2011), CCHPR (2012), Donner (2011), Gibb and Leishman (2011), Hawtrey (2009), Kemp (2007), Lawson et al (2010), Lunjanen (2004), MacKinnon (2012), McCrone and Stephens (1995), O’Sullivan (2010), Schwartz (2012), Stephens, et al (2002), Whitehead and Scanlon (2007), Williams et al (2012) as well as the recent DCLG Select Committee: House of Commons, 2012). We also reviewed think-tank housing strategies (e.g. Morton (2010), Hull and Cooke (2012) and BSHF (2011). The research then went on to examine innovative (though in some case longstanding) innovative policies that reduce the cost of affordable housing supply in the different jurisdictions of the UK, across Europe and further afield in Australia Canada and the USA. These were assessed against consistent criteria that include: public purse value for money, the scope to deliver scale or volume, efficiency and effectiveness, identity of who will be housed, and general policy transferability (Hall and Gibb, 2010).

Implications
The main findings from this review were:

- There are no simple market solutions that will close the gap between private cost and return requirements that can provide affordable outcomes for households without effective subsidy of some kind.
- The national housing system and all of its institutional features and path dependencies, including its interaction with the welfare benefit system, is a critical frame within which approaches to finance innovation take place and policy transfer is contemplated (Stephens, 2011).
- Many models and potential approaches exist or can be conceived but they all have strengths and weaknesses (CCHPR, 2012; HoC, 2012) when set against key criteria, such as scalability; dependence on supporting, complementary institutions (e.g. housing benefit); value for money; and effective targeting on client groups.
- There needs to be clear aims and objectives not just about individual policies but the mix of policies and their system-level coherence, including how they are delivered and by whom (especially relevant to a devolved governmental system).
- The understandable efforts to develop a larger private sector equity or debt position in these new models, alongside the requirements they bring (e.g. minimum rates of return, exit routes, and the like) necessarily narrows the window of what is possible and for instance makes higher (e.g. mid market or intermediate) affordable rather than social rents a necessity – and this has knock-on effects elsewhere in the system such as benefit costs and for not for profit governance.

In the main report we discuss several sets of policies, noting that elements of the UK innovations are new, untested and may indeed not actually achieve what they set out to do. As well as much policy innovation, particularly in England, being in a state of some flux and confusion, with new announcements made which do not always cohere with existing policy frameworks or indeed other recent announcements or are better
conceived of as policy objectives with the methods still to be worked out – e.g. the recent proposals for waiving S106 requirements and the £10 billion housing association state-backed loans announced in September 2012. In the main report we focus on 12 major policy areas, plus a couple of additional UK-level clusters of current or recent innovation (see box).

### Innovations Examined

1. The Australian NRAS model.
2. The Canadian Ontario ‘silent’ second mortgage.
3. The US low-income housing tax credit.
4. Danish housing association surplus recycling fund.
5. The Irish (RAS) long lease discounted rent model for the PRS.
7. Dutch housing associations guarantees and funding system.
8. German tax arrangements for private landlords.
9. UK Social REITs.
10. UK Syndicated bonds for smaller housing associations.
11. UK state-backed housing association bonds.
12. UK partnership models.

The implications for the UK from the international evidence can be summarized briefly.

- All three Anglo-Saxon models (Australia, Canada and the USA) represent different configurations of local and national interventions within federal systems of governance. The UK’s devolved system of government echoes this relationship but is different in important specifics.
- The Australian NRAS scheme combines scale, competition between different kinds of providers and encourages the blending of different sources of support, including private sector funds.
- As with Social REITs and sale and leaseback schemes – the NRAS case illustrates that a critical role for not for profit providers is providing management functions as a project partner.
- The Canadian model targeted at supporting home ownership through a second mortgage, is more modest. In its own terms it is, however, well-designed and also encourages contestable supply between different types of providers.
- Given the nature of home ownership entry pressures in many UK markets there is little doubt that the simple and transparent silent mortgage approach
has potential for transfer and, in terms of long run public spending, might be more cost effective than present UK LCHO approaches.

- The US LIHTC has generated large volumes of affordable housing through use of tax credits and the tax code, incentivising private investors to support local level affordable housing.
- As was found in the Australian and Canadian cases, the LIHTC has promoted contestability between different types of providers and supported different forms of innovative partnerships, including other sources of funds.
- The Spanish VPO scheme is a combination of subsidy with subsidy elements that is attractive from a British perspective. It is flexible (though not completely transparent) but has suffered in the recent downturn. But the scheme is readily transferable (it would not require new institutional infrastructure) and could support stimulus activity.
- The Danish housing association surplus building fund is a well-established programme operating in a relatively similar model to post 1988 UK housing associations. Notwithstanding institutional governance and autonomy issues, Denmark’s case shows that internal funds can replace scarce public subsidy for construction and that there can be indirect ownership over fund disposition. It could operate as a revolving fund.
- Irish long lease (RAS) properties appear to offer quality-adjusted lower rents than the market and are cost-effective in that the leases, while longer than market tenancies remain shorter than average social tenure tenancies.
- Dutch guarantee and funds. There is an argument that can reasonably be made that we need to be familiar with the advantages and disadvantages of this system since there is a sense of a creeping move slowly towards key elements of the Dutch system, again highlighted by the recent announcement guaranteeing £10 billion of social housing investment and newspaper reports that English housing associations are considering investing in Dutch housing.
- Tax advantages may be an important reason for the much envied stability of the German housing system. However, while some of the principles could be applied, the German principles of taxation look quite different institutionally, nonetheless, the German case does suggest that there is merit in considering tax incentives, especially if they can be traded-off with greater tenure security or longer leases.

Conclusions
The setting in which affordable housing supply is financed is difficult and likely to remain so. Not only is subsidy significantly curtailed and traditional bank finance expensive, in finite supply and focused increasingly on shorter term funding, but the future of housing benefit and working age social security benefits present major risks for tenants and for provider income continuity. We make strong assumptions if we imagine that housing benefit will safely continue to ‘take the strain’.

Reduced grant and the need to substitute equity or private debt make intermediate rent and partnership more likely for the channel that had been dominated by housing associations. This opens the door for a range of structured partnerships and vehicles, which may be able to produce more of these opportunities where demand is sufficient and the rent still genuinely affordable. Key questions going forward would seem to be:
• How best to tackle the approaching borrowing capacity constraints facing social providers that bodies like NHF argue will emerge before the end of the current UK Parliament?

• Will the funds and other institutions became more embedded as long term players in affordable housing finance (and not just purchasers of bonds)?

• Can and should providers encourage equity in partnership or through going for profit?

• Can more be made of devices like revolving funds to help fund land and short run development finance? Can more be made of deferred land costs and access to public land at sub-market prices?

• Should we make more use of state guarantees? The Government is sending conflicting messages with support for £10 billion of loan to social providers but the recent Montague Review implying that these are distortions to be avoided. There is a second best argument that any distortions are well worth it if they unlock supply by reducing borrowing costs and incentivising the supply of credit.

• A wider question is whether, as with the Netherlands and the Danish case, guarantees could be funded through one use of recycled surpluses from the providers themselves as part of a club? Can they reduce borrowing costs and address the concerns of providers that an element of surpluses and reserves are required for long term repairs and other designated uses like prudential risk management? The Dutch also found that this model led them into contentious debates regarding state aid.

• Should mortgage guarantees or equity loans or funds that pay for indemnities replace or complement up front grants for shared ownership/shared equity?

There is no silver bullet but a range of deals, ideas, negotiated trade-offs and opportunities. Some depend on local networks, others on existing financial strength. The undeniable fact, however, is that the affordable rent sector not social rent is where new supply will predominantly come from and this will over time transform the sector (certainly the development end of it). However, it may not lead to consistently more affordable supply across the country and it may cost the Housing Benefit bill much more (though this is an empirical question).

The different instruments examined reflect a new era in housing subsidy arrangements. Many of the measures are open to a range of potential investors, to provide different products that provide flexibility in the policy choices and blend different forms and providers of support. This reflects the, often implicit, emergence of an understanding that affordability is not one problem but several very different issues applying across a spectrum of income/age groups and the emergence of cross tenure providers/operators. It is also about the extent of local choices versus central top-down priorities in policy priorities.

Converting these ideas and policy instruments into a coherent package is not straightforward. But the key issue about a ‘package’ is who offers it and at what level? Is it the UK government (or its devolved compatriots) offering a package as possibilities rather than in some defined mix? Or is it the package that local strategic authorities and then providers will have to put together? Perhaps, there needs to be set out a nested menu of instruments? Identifying a suite of promising financial innovations is one thing. It then has to be delivered efficiently and cost-effectively.
References

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