findings

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Housing associations, private finance and market rents

The ethos of developing associations has changed - because of falling grant rates and the introduction of private finance - to one which places far more emphasis on financial surpluses and thus increasing rents. Existing tenants are therefore subsidising new development. Research by Christine Whitehead and members of the Property Research Unit, Department of Land Economy, University of Cambridge shows that:

- **Most housing associations are financially secure and could withstand significant increases in costs. Their position is particularly strong at the moment because of falling interest rates and development costs.**

- **Although associations' reserves are growing, these are often illiquid and are not available to deal with sudden crises. Few associations plan effectively for future major repairs.**

- **Many associations have little unencumbered stock, but could restructure their existing loan portfolios to allow them to continue to borrow and develop.**

- **Associations' rents have been increasing by 3 per cent per annum more than the private sector; some are already higher than for private sector units of similar size. Average rents in the two sectors could converge by the end of the century.**

- **Current grants are not high enough to finance new development at affordable rents. Diverse associations have kept rent increases to around 4 per cent per annum since 1990, but the rents of small, younger, specialist associations have risen by around 12 per cent.**

- **Where average rents are close to or above market levels, some working tenants are choosing cheaper accommodation in other sectors, leaving associations more dependent on housing benefit.**

- **Housing association rents are not being referred to the rent officer, even when they are higher than market levels - but this could change, putting rental income at risk for associations with little capacity to cross-subsidise.**

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Housing finance

The research questions

The 1988 Housing Act brought housing associations in England into a more market oriented and risky environment. In particular, associations were required to raise the difference between a decreasing housing association grant and the actual cost of development on the private market or draw down from their own reserves, and were given the powers to determine their own rents in order to cover the costs involved.

The research aimed to evaluate the position of housing associations after nearly seven years in this environment. It concentrated on three main questions: what factors help to determine the financial strengths and weaknesses of different types of association; the extent to which the rents they are now charging on these developments are tending towards market levels; and, more fundamentally, whether the current financial position allows associations effectively to maintain their social housing role.

The work involved three distinct projects, the first looking at what private lenders require from associations in financial terms and the ways that associations are adjusting to this environment; the second concentrating on how association rents have changed in comparison to rents available to similar households in the private sector; the third looking at the position in remoter rural areas where there are particular problems of high costs and low tenant incomes. Here we report on the main findings, bringing together the outcomes of the three projects to address the fundamental issue of the link between the financial strengths of associations and their rent setting policies.

The financial strengths and weaknesses of associations

In addition to statistical analyses of developing associations, we examined the financial circumstances of a sample of 54 of these associations. We then undertook detailed case studies of 12 associations of different sizes and attributes from among this group. Almost all associations in the sample were able to service their existing loans out of current rental income and indeed were able to add to their surpluses on general lettings. In all but three of the case study associations, surpluses on the income and expenditure account had been increasing rapidly. Forward projections suggest that this position will continue to improve, with continuing growth in surpluses in all associations and more rapid growth in income cover. In part this is because in nearly all cases associations were projecting rent increases above inflation. In part it reflects continuing low interest rates.

Although the projected financial position of some smaller associations is improving more rapidly than that for some larger associations, the small associations clearly see themselves as being at a disadvantage. The terms and conditions of their loans were often more onerous, they felt the pressures of having fewer specialist staff and, in terms of objectives, stressed financial viability at the expense of rent levels.

Sensitivity analyses evaluating the effect of changes in interest rates, decreases in rental income and rises in other costs all suggested that associations could pay their way in the face of worsening economic conditions, although some would find it difficult to continue to develop.

Most associations do not appear to have a formal policy on reserves, except to increase them. In over half of the associations, of all sizes and types, reserves are not backed either by cash or longer term financial assets. Hence retained reserves are not readily available to deal with immediate unforeseen financial problems.

There is considerable evidence that when associations are under budgetary pressure, it is often the maintenance expenditure that suffers. Indeed 60 per cent were underspending in relation to Housing Corporation allowances. Associations are also only just beginning to address the issues of longer term cost profiles and financing strategies for major repairs.

In terms of development potential, over 40 per cent of associations in our sample had no stock unencumbered with debt and the majority had less than 10 per cent unencumbered. On the other hand, 85 per cent of associations in our samples had debts accounting for less than 40 per cent of asset values - which is certainly low enough to meet the lenders' requirements. Most associations are thus in the position to restructure their debts to maintain development if they so wish. Although adequate asset backing is perceived as being crucial, lenders are now placing greater emphasis on the security of the assets underlying cash flows, especially future rental income streams.

Housing association and market rents

In looking at the relationship between housing association and market rents we examined national and local data, analysed the results of a questionnaire of all developing associations on their rental policies and undertook detailed case studies of ten inner urban, urban and rural areas.

At the national level, housing association new let rents have on average risen by 3 per cent per annum faster than private sector rents as determined for housing benefit purposes during the 1990s. If this trend were to continue, the differential between the two sectors would disappear by the end of the century. In some regions, notably the North and the Yorkshire and Humberside regions, average association rents are already close to or above private sector rents. Across all regions, the gap is least for smaller units and there is significant evidence that associations are cross-subsidising internally from smaller to larger units.

In making these comparisons, we are not comparing like with like in the sense that a tenant would receive the same quality of accommodation for a similar price. Rather we are comparing what is available in one sector for particular groups of households to what is available in another. Where rents are lower in the private sector, tenants have the choice of lower quality/lower priced accommodation. Moreover, it would be open to local authorities to refer associations' high rents to the rent officer and to restrict the level of housing benefit on the grounds of the availability of comparably sized property. At the present time neither referral nor restriction is generally occurring and there is no incentive for authorities to do so. However, this could change, especially if private tenancies at comparable rents became more generally available.

On the basis of the questionnaire and CORE data, it was possible to link the attributes of associations with their rent profiles. In general, the higher the proportion of mixed funded stock, the higher the average rents charged by the association. Equally, associations which operated in only a small number of local authorities usually had higher rents than those operating over a wider area. Finally, smaller associations (those with less than 100 units) charged higher rents than larger associations. Overall, highly diverse associations with a large proportion of pre-1989 stock have been able to keep rent rises to around 4 per cent per annum in the 1990s while small, concentrated associations with a high proportion of mixed funded accommodation had increased rents by around 12 per cent per annum.

Some of the questions raised from the statistical analysis were addressed in more detail by case studies of areas where rents tended to be close to market levels. The studies in inner urban areas suggested that the problems of relatively high association rents arose in areas where private sector rents were particularly low, suggesting an overprovision of low quality housing and few investment opportunities. Association rents were not particularly high in national terms and housing benefit officers justified not referring rents to the rent officer on the grounds that the costs had been sanctioned by government and quality was higher

There were few cases where rents were above private sector levels in urban areas. Where they did occur they appeared to be mainly because larger, diverse associations were not adjusting for local conditions - in other words, the associations had the capacity to change their rent structures to address the problem. There was however evidence that associations with higher rents were catering for even higher proportions of households on benefit than in other areas.

Rural areas

In rural areas, association rents were not in general above market levels. However where they were above market levels, the problem was one of relatively high development costs which smaller, newer associations were unable to pool across their rental stock. Moreover, the rents set by such associations were higher than those set by older, larger associations for similar property. In one instance the difference for basically the same property was £20 per week.

Because of the concentration of problems in rural areas we undertook a further study of fifty-three remote rural areas looking not just at rents but also the financial position of specialist associations. Additional case studies were also undertaken in areas where the statistical evidence suggested some rents were within 10 per cent of market levels. This more detailed study showed that while it was the smallest associations that were having the most difficulty in setting rents below private sector levels, in fact relatively few such associations were developing. In order to survive effectively in rural areas where costs were high and incomes low, associations had to be relatively large and diversified and so able to cross-subsidise from other areas. They also had to be financially strong.

Evaluation

Overall the evidence from the three studies suggested that associations were adjusting to the new environment by increasing surpluses and rents. Even so, association rents were generally well below market levels. However, if trends were to continue, rents would tend to converge and there is already some evidence that working households are looking elsewhere. Where there are problems, larger, more diverse associations have greater capacity to modify their rent structures but this means not only that existing tenants are subsidising new development but also that tenants in some areas and in some types of property are paying for others, usually in larger units and in local areas where private rents are relatively low. Associations are adjusting to finance market pressures by increasing rents to improve their financial position. They need to take equal note of local housing market conditions.

About the study

In all three projects, the approach included both analysis of statistical data and case studies of particular areas and associations.

Details of the approach, the analysis and the findings from the three studies are available in four separate reports: *Housing Association and Market Rents in England*, Department of Land Economy Discussion Paper No. 48; *Housing Associations, Private Finance and Market Rents in England's Rural Districts*, Department of Land Economy Discussion Paper No. 49; *Private Finance for Housing Associations: What Lenders Require and Housing Associations Provide*, Department of Land Economy Discussion Paper No. 50 (all available from the Publications Secretary, Department of Land Economy, University of Cambridge, 19 Silver Street, Cambridge CB3 9EP at £15 plus £1.95 p&p each); and *Association Rents and their Rent Policies* 1991-1994, available from the NFHA, 175 Gray's Inn Road, London WC1 8UP. (Tel: 0171 278 6571)

Further information

Further details of the findings and the analysis on which they depend can be found in Rents and risks: Investing in housing associations by Russell Chaplin, Michael Jones, Simon Martin, Michael Pryke, Caroline Royce, Paul Saw, Christine Whitehead, and Jin Hong Yang. This is published by the Joseph Rowntree Foundation, price £9.00.

Related *Findings*

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