JOSEPH ROWNTREE FOUNDATION

INSPIRING SOCIAL CHANGE

INNOVATIVE FINANCING OF AFFORDABLE HOUSING

Public funding cuts and scarce mortgage credit have made it much more difficult to finance the supply of new affordable housing. This study highlights promising policies from the UK and abroad that provide innovative funding ideas to increase the supply of below-market-price housing.

Key points

- The general shift upmarket to supply shallower subsidy and affordable rather than social housing means higher rents and more limited security of tenure. This will have profound consequences for people on low incomes.
- This movement, amplified by innovations found elsewhere, suggests a number of emerging themes. On the one hand, there is a desire to use more state-backed guarantees, encourage competition among providers, sweat existing assets and encourage alternative sources of provider income. On the other hand, opportunities also exist to 'blend' different subsidies creatively and encourage solidarity-based co-operation among providers.
- In the longer term, fundamental market failures such as in the land and credit markets will need addressing, and funding programmes for social housing prioritised if rising housing need is to be met. This will need to be part of a clear, overarching policy vision identifying the overall mix of policies, which would also need to include how they are to be delivered and by whom.

The research

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BACKGROUND

Alongside a companion study on land supply (by the University of Cambridge), this review draws on national and international evidence on innovative ways to support financing for new affordable housing supply. It is set in a context of declining public funds for housing and mortgage market failure. Recent housing policy has focused on low-income households, because home-ownership and liberal mortgage lending catered for the great majority. This is now threatened. The Government seeks to encourage private-sector participation in higher-rent intermediate or affordable rented supply, rather than traditional social housing. This gives rise to tensions, because financial logic shifts the focus to the mid-market, whereas housing need suggests a requirement for more social housing.

Emerging themes

Despite an appetite for state-backed guarantees, caution is required. Guarantees have been debated in Europe as sources of unfair competition. Currently, given prevailing interest rates, investors may receive guarantees less warmly simply as a mechanism to reduce borrowing risk and hence the cost of borrowing. Moreover, recent financial governance problems associated with Dutch social housing are a warning to the UK. There have been concerns about market distortions associated with state-backed guarantees. However, the Scottish National Housing Trust offers a low-cost intermediate solution with potentially flexible exit routes, and including more long-term and social provision options. Competition or contestability among providers (both for profit and non-profit) is important, encouraging efficiency, lower subsidy costs and experimentation.

The evidence suggests that subsidy can be distributed from the centre (national tax authorities or federal programmes) to lower tiers of government, which have more local freedom to augment subsidy (with land, for instance) for locally tailored, affordable solutions. Such arrangements are possible in the UK. Subsidies from different tiers of government and agencies in federal/devolved systems could be combined, as a more discretionary and flexible use of subsidy. Again, this can promote experimental, tailored solutions.

Innovation in housing policy is increasingly 'bottom-up', with national policy responses framed around relatively simple supports that can be locally blended and augmented to serve different purposes. However, the need for value for money means that tests are required to ensure that subsidy is not over-provided or poorly targeted. Regulators could oversee subsidy systems, through tests by relevant agencies checking for value for money, or by incentivising bidding mechanisms.

Various European systems indicate that social housing can benefit financially (and in its governance) from more solidarity-based or collaborative structures. While this may not be culturally translatable to national non-market housing systems in the UK, it may be feasible on a smaller, more local or specialist scale, such as community-based housing association clubs within a city-region. Collaborative models such as pooling and recycling surpluses and linked revolving funds – i.e. recycling original funding – could operate alongside subsidy mechanisms encouraging lower-cost and less-per-unit subsidy through competition.

Policy-makers and providers are increasingly interested in management income streams associated with real estate investment trusts, sale and leaseback vehicles and tax credit models. Additional revenue is also increasingly important to social providers, but is not a guaranteed source of income. In contrast to complex schemes, simple schemes that users can understand are valuable, as the effects are easy to follow and unintended consequences less likely. Canadian 'silent mortgages' (like second mortgages but where the repayment terms are flexible and may in fact be discounted in different ways) and policies like revolving funds possess these features.

The shift upmarket in rent levels has meant relatively shallow subsidy per unit, so that more units can be funded from a given sum of public money. If the overall funding programme still operated at pre-austerity levels, this resource could be stretched in terms of units completed. But mechanisms like the Affordable Homes Programme operate at much-reduced scale (they also risk not delivering the planned scale of output). The other key measure is 'sweating' providers' existing assets. The Affordable Homes Programme is such a process, capturing the rise in balance sheets and financial capacity associated with the property boom. This is a more volatile, risky approach. It depends on asset growth and maximum gearing of loans, raising new financial governance and regulatory requirements.

The scope for innovation is closely related to the regulatory context – not just social housing governance, but also the interface between non-profit housing and the private financial sector and its regulation. Public accounting rules also determine the degree of flexibility and providers' financial capacity to borrow when subsidy, public loans or guarantees are involved.

Transferable international policy examples

Many policies have merit for the UK context, but measured against the tests outlined above, six have particular potential:

1. *The Spanish VPO ('officially protected housing') developer/occupier new supply subsidy*. This has provided scale, responsiveness and efficient subsidy but, while means-tested, has been less tightly targeted and has somewhat succumbed to the economic crisis. It is flexible in principle, if not completely transparent. The scheme is readily transferable as it would not require new institutional infrastructure, and could stimulate activity.

2. *The Australian National Rental Affordability Scheme (NRAS) tax credit application of the US low-income housing tax credit model*. The combination of competition among providers, opportunities to blend subsidy and beneficial placemaking (designing and managing public spaces through ongoing consultation with the local community) are attractive innovations. NRAS targets moderate-income households, with capped subsidy, and can operate responsively and to scale.

3. *State-backed loan guarantees on the lines of the Scottish National Housing Trust,* rather than as a way of generally lowering the cost of bonds (as the new English £10 million fund will do), or *a Dutch-style guarantee and governance model*. The Scottish model offers tailored outcomes and is only a marginal public finance commitment.

4. *Policies to assist sustainable home-ownership*. These include first-time buyer policies that assist with deposits, via the Canadian silent mortgage or adjustment to FirstBuy or NewBuy models, such that the indemnity allows for a slightly higher (or more conservative) deposit percentage than the 5 per cent currently in practice.

5. *The Danish housing association national surplus fund*. While based on solidarity principles that may seem alien to the UK, this allows creative use of surplus funds, though the Government may simply offset the fund with lower subsidy. However, this may be a more acceptable way voluntarily to unlock housing association long-term 'free' reserves.

6. *The Irish model of private renting with a discounted long-lease rent*. This addresses work incentives and augments affordable supply by binding private landlords into long leases and sub-market rents. This model has grown quickly in Ireland and may act to limit future social security expenditure.

Conclusion

A strategic housing policy needs suitable framing within a long-term policy vision rather than tackling crises as they arise. Long-term housing policy needs to address market failures such as in the credit market and seek to permanently reduce housing market volatility. That means re-examining housing taxation and the safety net for vulnerable home-owners. It would also mean supporting the private rented sector's wider market role (for example through developing investment linked to Self-Invested Pension Plans). Long-term flexibility in housing supply needs to be increased systematically, which will involve changes to the land supply and planning system.

Caution is required to avoid hasty transfer of policies from abroad. While this review has identified interesting ideas with potential value for the UK, it would be important to test their performance and assess their institutional suitability for transfer (e.g. the role of welfare benefit regimes in shaping and sustaining housing supply).

The financial crisis and its ramifications have initiated a fundamental reassessment of how to provide non-market housing, who will receive it and on what terms. Affordable housing policy, while financially much reduced, is remarkably fluid and subject to innovations and novelty. It remains essential that such innovation be securely located in a long-term policy framework that is coherent, progressive, inclusive for those in pressing housing need, and consistent with tackling market failures.

About the project

The researchers reviewed UK and international research and grey policy literature on funding affordable housing supply. With the help of in-country experts, a long list of potentially valuable policies was then identified before a shortlist of policies from eight countries was evaluated in detail against consistent criteria. A similar process considered innovative affordable supply policies from the UK.

FOR FURTHER INFORMATION

This summary is part of JRF's research and development programme. The views are those of the authors and not necessarily those of the JRF.

The full report, **Innovative financing of affordable housing: International and UK perspectives** by Kenneth Gibb, Duncan Maclennan and Mark Stephens, is available as a free download at www.jrf.org.uk

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