Funding New Homes with HCA Grant and Other Sources – Risks and Regulations
Highlight the key criteria applying to grant funding in the AHP 2015-18

Explore some other opportunities to subsidise affordable housing production

Identify some of the main risks associated with funding options

Provide some guidance on regulatory issues which relate to RPs funding new homes
1. Grant Funding in the Affordable Homes Programme 2015-18

- New programme continues but develops the themes evident with AHP 2011-14 funding, i.e.
  - grant rates are expected to be at minimum necessary levels
  - recipients will be expected to commit to a Framework Delivery contract with the HCA
  - RPs will be expected to sweat their existing assets and other sources of funding to contribute to the grant funded programme
1. Grant Funding in the Affordable Homes Programme 2015-18

- Most RPs experienced significant challenges delivering their current AHP programmes including:
  - significant time pressures on delivery creating rather artificial market pressures including increasing build costs
  - reliance on difficult to predict construction costs and timescales at the point of contracting with the HCA
  - substantial slippage in S106 scheme included in bids to depress unit grant levels
  - capacity problems generally in the construction industry
  - lower internal subsidy than anticipated from both conversions of tenancies (from social rent to affordable rent) and from disposals (especially shared ownership disposals if included in the contract)
1. Grant Funding in the Affordable Homes Programme 2015-18

Key features of the grant funding criteria in the AHP 2015-18 Prospectus:

- completions are expected by March 2018
- encouragement to bring forward bids from RPs with under-utilised capacity
- a greater proportion of one and two bedroom homes
- additional contributions to come from:
  - borrowing capacity from conversions
  - disposal receipts
  - other cross subsidy
  - surpluses
  - RCGF and DPF
  - free and discounted land
  - new homes bonus or other LA contributions
  - government backed funding guarantees
1. Grant Funding in the Affordable Homes Programme 2015-18

- rents to be ‘affordable’ at 80% of market rents
- only RPs with a contract can charge affordable rents (including on conversion of tenancies)
- active asset management strategies
- ‘bear down on the costs of new supply’ – innovation in procurement and construction methods
- ‘mixed’ or ‘firm scheme’ approaches to bidding
- mixed is only feasible where grant requirement exceeds £5m and continues to do so after post bid scrutiny
- S106 schemes only to be included in bids where they are named firm schemes
- investment partnerships are still encouraged
- LAs can bid if they have HRA headroom
- other affordable schemes in the bidding RPs programme will be subject to the HCA contract.
1. Grant Funding in the Affordable Homes Programme 2015-18

- Key challenges:
  - is it a fair deal? Is the grant offer really ‘something for something’ as the Prospectus suggests?
  - the continuing emphasis on affordable rents does present affordability problems – although usually less acute for smaller units
  - social rent can be included in programmes which are not grant funded but come into the contract
  - supported housing schemes at social rents will be subject to scheme specific tests and only approved for grant funding on an exceptional basis
  - HCA is looking to capture receipts from disposals driven by asset management to subsidise the grant programme. This will reduce other internal subsidy potential
1. Grant Funding in the Affordable Homes Programme 2015-18

- some assets may be considered for disposal that ought to be retained, especially high value properties, reducing affordable housing in more expensive localities
- increasing pressures on RP business plans could present challenges in relation to lender covenants
2. Other Options for Funding a Development Programme

- Why does affordable housing need subsidy?
  - The key to viability for new rented housing development is making the net revenue stream service the cost of money borrowed to meet capital costs.
  - If the capital cost is greater than that which can be serviced from expected revenues then there needs to be a subsidy sufficient to bring the net capital cost (the debt) down to a viable level.
  - Even the viable level of debt assumes early years’ revenue subsidy. The effect of inflation over time moves schemes from notional deficit to notional surplus. The viability test discounts anticipated revenues and costs over a pre-determined period, often the period of the loan, and looks to achieve a ‘break even’ financial position for all of the income and expenditure over the period.
2. Other Options for Funding a Development Programme

Cumulative Breakeven

- Costs
- Rent
- Years
- £
- Deficit
- Surplus
2. Other Options for Funding a Development Programme

- Typically, a family house might cost between £120,000 and £160,000 to develop with construction, fees and possibly some land value. With an affordable rent, revenues might be expected to support about £90,000 of borrowing. So, we might need between £30,000 and £60,000 subsidy.
2. Other Options for Funding a Development Programme

- **Low cost public sector land**
  - Mainly from local authorities and transferred to RPs at no or very low cost.
  - Other surplus public sector land, increasingly parcelled by the HCA but not always available at a discount.

- **The planning system (low cost private sector land)**
  - the operation of affordable housing planning policy via planning obligations (S.106 agreements)
2. Other Options for Funding a Development Programme

- **Cross subsidy**
  - scheme (usually market sale and usually land value only)
  - programme
  - business-wide (this is already the underpinning feature of conventional grant-funded development)

- **Intermediate tenures**
  - shared ownership or resale covenant is often viable without grant where land is free or discounted
  - intermediate tenures can on some schemes be a source of cross-subsidy to support rented homes
2. Other Options for Funding a Development Programme

- Re-investment translated into new development
  - this is ‘active asset management’ and often emerges from a more thorough evaluation of existing assets
  - where those existing assets are actually liabilities in the longer term and cannot be economically improved, re-development even without grant can provide an improved business plan position and is therefore a wise investment.
2. Other Options for Funding a Development Programme

- Increasing commercial activity – more cross-subsidy or better viability
  - RPs taking a more direct role in market housing or in other commercial development and capturing improved profits in order to plough some or all of these into subsidising affordable housing
  - A scheme where the provider wholly or partly funds work in progress on market sales, right through to point of sale, will secure a big improvement in receipts from these dwellings compared with a land only deal. But risks are much higher
2. Other Options for Funding a Development Programme

- **Sale and leaseback and other investor led schemes**
  - Growing enthusiasm for participation in the housing market by investment institutions
  - Appetite driven by low returns on alternative secure investments like Government securities and agricultural land
  - Investment criteria include:
    - Very low risk
    - Large scale opportunities
    - Predictable returns
    - Low investment management costs

- **Supporting LAs developing in the HRA**
  - Essentially an agency service
  - A number of stock owning LAs or ALMOs are planning to develop new homes and most do not have a development establishment
3. New and Intensified Risks

- Reliance on rent inflation from a high base position
  - At 80% of market rent, it takes 8 years to hit market rents if there is no market rent inflation and affordable rents inflate at 3% p.a.

- Consigning customers to welfare dependency (note welfare reforms)
  - Especially true in areas with higher market values
3. New and Intensified Risks

- More competition from other providers
  - Stock owning LAs
  - Some private sector organisations have growing interest in directly developing and then managing affordable housing portfolios:
    - Crest Nicholson
    - Grainger
    - Firstbase
    - Kier
    - Quintain Estates
3. New and Intensified Risks

- Cultural or operational resistance (including skills shortages)

- Distraction from improving existing assets

- Different Customer Expectations We Don’t Understand
  - Some RPs already having to radically shift perceptions of customers and presentation of product and services to reflect different markets – see Fizzy Living – Thames Valley Housing’s PRS product
3. New and Intensified Risks

➢ More Fluid Demand
As products diversify, demand needs to be studied and assessed as does the extent to which new forms of provision might be exposed to greater competition. Certainly, market sale housing is a highly competitive market and price sensitivity, product presentation, procurement efficiency and managing the planning system to best effect are all crucial components in a successful programme. These aspects of marketing and product development are skills not well developed among affordable housing providers.
Delivering positive change on behalf of our clients for the benefit of their customers