# The Affordable Homes Programme: The NAO Assessment

**The National Audit Office (NAO) has recently published its analysis of the financial viability and value for money of the government's Affordable Homes Programme (AHP). This briefing looks at the detail of the NAO report, its main recommendations and the key questions and issues for London Councils.**

## Overview

In October 2010 the government formally announced the introduction of an Affordable Homes Programme (AHP) starting from April 2011. The AHP is intended to deliver new housing with a third of the grant per home of earlier affordable housing programmes. Under the AHP, Registered Providers (RPs) submit bids to the Homes and Communities Agency (HCA) for part funding to build new homes. The remaining necessary funds are made up from a combination of loans from lenders, higher rents for the new homes built and also by increasing rents on some existing homes as they become vacant. At its launch the programme had an initial aspiration to deliver 56,000 affordable homes.

In July 2012 the National Audit Office (NAO) published its analysis of the financial viability and value for money of the programme.

The primary tension that the report explores is that between the relative merits of: maximising the number of homes built, minimising the housing benefit bill and maximising the use of RP resources to leverage funding. Among the key NAO report findings were:

- Looking over a 30 year horizon, continuing to fund new affordable housing supply through the existing model of the National Affordable Homes Programme (which offered higher levels of grants to RPs to build new homes) would offer the overall best value for money (largely because it would lower the housing benefits bill). However, given the restrictions in available grant, this model would deliver a substantially lower number of housing units and would make less use of RP borrowing capacity.
- In terms of the potential overall delivery of homes, the AHP was deemed to be a success, with providers committing themselves to building some 80,000 homes (between 2011 and 2015) against £1.8 billion of government investment, compared an initial target of 56,000 new homes.

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- The CLG will need to carry out a thorough analysis of providers' ability to replicate the 2011/15 programme.
- The programme design increases providers' overall financial exposure.
- The HCA should follow a more structured decision making process concerning the evaluation of ARP bids.
- The NAO identified a range of key programme delivery risks, including:
  - nearly a fifth of contracts with housing providers remain to be signed
  - more than half of the planned homes are not currently due to be delivered until the final year of the programme
  - some providers are concerned that they may not be able to charge rents at the levels they originally agreed with the programme.

## Analysis

Compared to previous housing delivery models, the AHP was unusually swiftly implemented, being up and running within six months of its announcement. It was also introduced against a backdrop of exceptionally high economic uncertainty. Despite this (and to the surprise of many observers), the programme was oversubscribed with bids from 377 providers, resulting in the HCA agreeing, in principle, to the delivery of 80,000 homes, compared to the original estimate of 56,000.

The AHP involved the HCA paying substantially less grant per home than under previous schemes (£20,000 compared with £60,000 under the National Affordable Housing Programme), while housing providers have had to borrow more and charge higher rents.

The new scheme represents a reduction of 60 per cent in average annual spending on affordable homes over the four years of the programme from 2011/12 to 2014/15, when compared to the three years up to March 2011.

This has to be seen against the £2.5 million property estate of RPs, representing a book value of £109 billion delivering an estimated £10 billion overall rent income in 2010/11, with surpluses increasing by 80 per cent to £1.1 billion in 2010/11 from the previous year.

Overall, the NAO found that the parameters of the AHP were predicated on the basis of total RP sector growth (both turnover and surpluses) between 2009 and 2011, with operating margins rising to 21.4 per cent and a sector-wide surplus of £1.1 billion (see appendix 1). This, the NAO believed, supported the HCA and regulator's view that the sector had the financial capacity to invest more of its own resources into the AHP. However, this backward looking assessment is clearly tempered later in the report by a level of caution as to the impact of the current AHP on RP's future operating margins and surpluses, and specifically the state of RP balance sheets after a four year AHP programme.

### In terms of the overall programme, the NAO's other key findings included:

While the CLG undertook a modelling exercise to assess the impact of the programme to providers, its analysis did not state the number of tenants who would be affected or the effects on individual tenant's incomes.

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The CLG achieved its overall policy objective of maximising the number of homes delivered through the AHP within the envelope of the available grant funding. However, it found that the lower unit subsidy of £20,000 compared to £60,000, would result in increased housing benefit cost with a net present value of £1.4 billion, or £17,500 per home.

## Overall cost benefit of the ARP

| Cost to central government | Central estimate (£bn) | Type of costs | Who bears the cost | Comment |
|---|---|---|---|---|
| Programme capital funding | 1.6 | Cash | HCA *(Now in London the GLA)* | The total overall grant to build new homes going to RPs and some Borough |
| Increase in HB expenditure | 1.4 | Cash | DWP | The additional HB cost as a result of higher rents. |
| Employment and Council tax | -0.5 | Cash | Employees | Construction employees' tax. |

## Is the AHP repeatable?

The short answer from the NAO, is that it's not sure. Focussing on a combination of the first round of the AHP and a changed lending environment that has created more uncertainty, coupled with a varied response from RPs to the AHP and (it can be speculated delivery issues), the NAO recommends that the CLG carry out "a more thorough analysis of the financing of individual RP's" to understand and assess the scope for a further round of the AHP post 2015.

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The NAO adopts a measured view as to the repeatability of the existing AHP. While it acknowledges that many RPs have benefited from reduced borrowing costs, these lower costs have been mitigated in many instances by the need to offer additional security to banks through the use of financial derivates as a way to 'fix' interest rates, mainly in the form of interest rate swaps. Indeed the Tenants Services Authority (TSA) reports that 46 RPs are using derivatives to fix the interest rates on £9.3 billion of debt.

## Comparison - Funding a new home under the NAHP and AHP

| Construction financing | NAHP | AHP |
|---|---|---|
| Borrowing supported from 'new' rents | 61,000 | 75,000 |
| Average grant per unit | 60,000 | 20,000 |
| Other funding | 34,000 | 46,000 |
| Total scheme cost | 155,000 | 141,000 |
| Rent | 4,698 | 6,552 |

## Commentary

Overall, the NAO gives a critical thumbs-up to the affordable housing programme and, within clear parameters (see below), it believes that it maximises the overall delivery of homes within the funding envelope available. In terms of the broad programme, the NAO reflects many of the issues that London Councils and the boroughs have been raising since October 2010, namely:

- the need to carefully manage the risk of overall programme delivery
- the (not insubstantial) risk that the delivery of over 50 per cent of the AHP's homes might not be delivered in the programme's final year
- uncertainty over future housing benefit reforms and the risk and impact this could have on programme delivery
- the lack of certainty whether the AHP is sustainable in the long term.

However, partly due to its limited remit it fails to address many London-specific issues which have been of concern, and in particular:

- the perverse incentive for RPs to levy higher rents for smaller properties, as an indirect way of constraining larger property rent levels
- the 'patchy' level and quality of discussion between some RPs and boroughs
- the differential level of rent conversions among some RPs and the impact this has had within individual boroughs
- emerging concerns among boroughs over the level and location of RP disposals in London.

**Author:** Nigel Minto, Head of Housing and Planning (T: 020 7934 9813)
**Click here to send a comment or query to the author**

## Links:

**Financial viability of the social housing sector: introducing the Affordable Homes Programme (NAO website)**

## This member briefing has been circulated to:

**Portfolio holders and those members who requested policy briefings in the following categories: Housing and Planning**

## Appendix 1

## Key financial highlights and indicators of the RP sector 2009 - 2011:

| Indicator/year | 2009 | 2010 | 2011 |
|---|---|---|---|
| Turnover | 11,565 | 12,280 | 12,647 |
| Operating surplus £m | 1,643 | 2,224 | 2,704 |
| Surplus on social housing lettings (£m) | 1,644 | 2,242 | 2,605 |
| Net interest payable (£m) | 1,891 | 1,895 | 1,959 |
| Operating margin (%) | 14.2 | 18.1 | 21.4 |
| Surplus for the year (£m) | 203 | 609 | 1,116 |