HOUSE OF LORDS

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Inquiry on

THE ECONOMICS OF THE UK HOUSING MARKET

Evidence Session No. 7 *Heard in Public* *Questions 111 - 122*

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4.35 pm

Witnesses: David Orr, David Montague and Ian McDermott

Members present

Lord Hollick (Chairman)
Baroness Blackstone
Lord Forsyth of Drumlean
Lord Griffiths of Fforestfach
Lord Kerr of Kinlochard
Lord Lamont of Lerwick
Lord Layard
Lord Teverson
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

David Orr, Chief Executive, National Housing Federation, **David Montague**, Chair, G15 Group, and Chief Executive of L&Q Housing Association, and **Ian McDermott**, Chief Operating Officer, Sanctuary Group

Q111 The Chairman: Mr Orr, Mr Montague and Mr McDermott, welcome to the Economic Affairs Committee inquiry into housing. Thank you very much for joining us today. May I start by asking you about affordability, which is a word that is bandied around a lot but seems to mean quite different things to different people? Indeed, when we had the Department for Communities and Local Government in, we were told that it was something akin to variable geometry, which was a somewhat surprising description.

You are in the affordable housing sector. When you look at or think about affordable housing, how do you gauge affordability? Do you look at income? Do you look at market rent and have a discount from that? How do you think about what affordability is and how to supply affordable housing to the market, which is one of the principal concerns of this inquiry?

David Orr: There have been different definitions of affordability over the years. Indeed, in a previous generation, the National Housing Federation itself tried to define affordability and did so on the basis of residual income—how much money you have left after paying your housing costs to be able to live. Such definitions have gone. I do not know about DCLG's definition, but affordability has become a word that now means anything to anyone and has no real traction.

We did some work last year with the Joseph Rowntree Foundation on what an affordable rent would be for people who are in low-paid employment and I think that is a decent starting point. If you are in full-time work in low-paid employment and if you have a rent that you can afford to pay from your income and still have enough to be able to live on, then I think that would constitute an affordable rent. But, of course, if you have an income of £1 million a year, a penthouse costing £5 million a year may well be affordable.

David Montague: L&Q is a charity and we provide homes for sale for market rent but our charitable purpose is met by providing genuinely affordable housing. We share the view of David and the National Housing Federation. Our rents, where it is our decision where to set them, are based upon an assumption that they should be no more than 35% of our resident's net income. That is the basis on which we set our rents. In London, that is broadly equivalent to 60% of the market rent. In Westminster, it will be 20% to 25%, in Bexley it will be 70% to 75% but, on average, it is around 60% of the market rent. The reality is that more often than not our rents are set not by us but by the GLA or by local authorities but, where we have the choice, that is how we set our rents.

Ian McDermott: I do not really have anything to add to what has been said other than that, as a charity, discharging our charitable purpose requires us to be meeting a need that cannot be met elsewhere. That relates back to the definitions that have already been given.

The Chairman: So if the calculation is by reference to a percentage of income, then clearly, in very expensive areas, it is very difficult to build affordable housing, hence your examples about Bexley and Kensington and Chelsea. Does that then push you, or force you in some way, to build affordable housing in areas that are not the most highly valued?

The corollary of that is: is it impossible for you to provide affordable social housing according to the definition that you have provided today in areas of central London, for instance, or maybe other city centres as well?

David Montague: It is far more difficult to provide genuinely affordable housing in central London and I think it is inevitable that affordable housing will be built in more affordable places. Much of the housing that we provide in London tends to be—well, certainly not in the most expensive central London boroughs.

Ian McDermott: May I add to that? I think that there is a distinction between the provision of social housing that exists at the moment and the provision of new social housing. We certainly provide social housing in places such as Westminster. What is much more challenging is the provision of new affordable housing in those areas.

Q112 Lord Lamont of Lerwick: May I ask about the extent to which the reduction in social rents will affect your ability to provide social rented housing? I see that the OBR has estimated that there will be 34,000 fewer new builds by housing associations as a result of the change. I think that Mr McDermott's Sanctuary Group has said that the changes have meant that your development programme in future would have less social renting and more low-cost home ownership. I am not quite sure what the reasons why one should substitute for the other would be.

Ian McDermott: It has a number of effects. First is that it obviously takes income, and therefore capacity, out of the organisation. Over the next four years we estimate that that will be in the region of £134 million. By the time you get to 2020, we will be losing about £54 million a year so it takes out capacity. Secondly, it makes the equation for rented housing more difficult because we borrow money over a 30-year period against the rental income. If that rental income is reduced, the amount of internal subsidy that we have to provide for any individual home will be greater. Therefore, not only is there less money but the affordable rented housing that we provide becomes relatively more expensive in terms of the amount of internal subsidy that we need to provide.

To respond to that, we are keeping our numbers very high but we are doing things that require less internal subsidy. The point is, social rented housing requires us to provide a significant internal subsidy. The less capacity we have, the less we are able to do that and the more that we have to cross-subsidise with other, more commercial activity.

Lord Lamont of Lerwick: What about efficiency savings? Again, perhaps surprisingly, the Sanctuary Group had thought that it was in a relatively strong position to mitigate the changes that have taken place, is that right?

Ian McDermott: Yes, that is right. We have done a lot, really, over the past two years to streamline our organisation to invest in our infrastructure and our IT systems to reduce our back-office costs. Going forward, we think that we are in a competitive position in terms of the cost base of the organisation. There is still more work to be done but we have certainly done an awful lot. Much of the recovery of the capacity that we have lost by the rent reduction will be made up by efficiency savings—not all of it; as I say, we will have to do more commercial activity to make up the shortfall, but a significant proportion will be made up by efficiency savings. We have already made the investment that allows us to make those efficiency savings. It is a moot point as to what an efficiency saving is. The only other thing I would say is that we will stop doing some of our community development activity, for example, which comes out of our operating costs. Whether you consider that to be a saving or not, there are good things that we were doing previously that we will not be doing going forward.

David Orr: Perhaps I may say something about efficiency and the expectation of what people believe will happen. I just want to give an example. A number of years ago, a housing association in West Bromwich employed six neighbourhood wardens. The association monitored very closely the impact of the wardens in terms of the cost of providing the service and the savings that were made elsewhere in the public purse. There were substantial savings: there were savings to schools because there was much less vandalism, and there were savings to the police because fewer cars were abandoned. There were a whole lot of savings of that kind. That programme was partly supported by government finance. For a variety of reasons, the government finance stopped and the housing association could provide only three neighbourhood wardens. Costs began to rise. Neither the police nor the education department were able to provide support because the money came from different budgets—you know how this operates. That organisation is now looking at an efficiency saving by removing the last of the three neighbourhood wardens, so there will be none. The overall cost to the state is likely to be greater but the association will be able to demonstrate that it has saved money. It is a moot point whether you could properly call that an efficiency saving.

There are of course savings to be made in any business anywhere in the world, and there are costs that you can drive out by being more efficient, but some of the changes that will be made will be reductions in service. I think housing associations are focusing very clearly on building new homes at the expense of some of these broader neighbourhood support services.

David Montague: Perhaps I may add to that. From an L&Q perspective, prior to the Budget we had a development programme for 50,000 homes. Half were for either market rent or market sale and the other half were genuinely affordable, so that is 50:50. The Budget took £55 million a year out of our rental income, similar to Sanctuary. As a direct consequence, we are now delivering 60% commercial and 40% affordable. We are driving efficiency hard but one thing that we have to do is provide more market rent/market sale housing to cross-subsidise less affordable housing.

Q113 Lord Forsyth of Drumlean: The Government have a target of 1 million homes to be built by the end of this Parliament. How much do you think housing associations are, or could be, capable of contributing to that target?

David Orr: We have done some fairly detailed analysis of information provided by members across the country. Post-Budget, provided there are no other adverse changes, I think that we might be able to provide as many as 300,000. However, as David has pointed out, a high proportion of those will be market product rather than affordable housing for rent.

The investment in a programme the Government have set up for 135,000 new homes for shared ownership will help enormously and is very welcome. But there is a major shift going on from housing associations building for social rent to them building for other tenures and doing a relatively small proportion of social rent. However, we think that 300,000 is possible in this Parliament with a fair wind and with no other changes.

Lord Forsyth of Drumlean: We had some evidence from someone at the Policy Exchange. He thought that you could do 100,000 a year. This is actually less, is it not?

David Orr: Yes, although 75,000 a year compared with where we are at the moment and where we have come from would be a pretty impressive outcome, given the changes that have been imposed on the sector. To get anywhere near 100,000 a year, I think that we would have to be involved in trading housing at a scale that would begin to affect what was happening in the market, and it would require easy, quick access to land and planning in a way that is not credible at present.

Lord Forsyth of Drumlean: One thing that private sector builders and others have told us is that a constraint on building these houses is the shortage of skills and people who know how to build houses, partly because of the impact of the recession. If you were to build 75,000 houses a year, to what extent would that take away resources from the private sector and limit its ability to meet its requirements?

David Orr: That is a good question. It may take some away. Some capacity is not being used at present because people have left the industry and are reluctant to come back. If there were wage inflation, some of them might come back, but of course wage inflation means that costs go up. It is also possible that people from other parts of the EU who were involved in construction a few years ago would come back.

David Montague: In the housing association sector, there is the ambition and the desire for the financial capacity to do much more. David has set out what the sector as a whole intends to achieve. My own organisation has trebled over the last year. G15, the 15 largest housing associations in London, currently has a pipeline of 93,000 homes. We have committed to doubling that number to 180,000, which is £50 billion-worth of investment. So there is a strong desire to do more.

You are right: the two things that will hold us back are land and skills. I think that between us we can sort out the land, and I think that we are beginning to reach a tipping point. We are seeing efforts from government getting close to yielding the land that we need to build these homes. If we can work together to have a guaranteed supply of clean, consented land, then between now and that pipeline being available, we can start to build the skills that are necessary. It is not just about skills; it is also about off-site construction. We need to develop a long-term strategic relationship with the people who can build off-site.

Lord Forsyth of Drumlean: But you agree with the figure? You cannot do more than 75,000 a year?

David Montague: I will defer to David on that.

David Orr: That is the combined figure that we have heard, adding together the ambition of members across the country.

Lord Forsyth of Drumlean: And that is not a constraint that arises from funding; it arises from the permissions and the lack of skills.

David Orr: If there were more funding, it might amend the balance of delivery, so we might see more affordable rent and a bit less market product. It might increase at the margins the number of new homes built but I think that we are now in a position where land and skills are the major constraints.

Lord Forsyth of Drumlean: Do you think that there is scope for altering your funding model in some way to help to increase the supply of lower-rent—I do not like the term "affordable"—properties that ordinary folk can afford to live in?

David Orr: We have moved in a very short time from a model that was predicated on government providing some up-front capital subsidy matched by private borrowing by housing associations—as a means of providing the subsidy that you need to have lower-rent homes—to a model where predominantly it will be a matter of housing associations trading their assets or making profits and, by doing those two things, generating the surpluses, or the profits, that then become the subsidy for providing the lower-rent homes.

There is a complete truth here—that subsidised housing requires subsidy. If it does not come from the public purse, we have to see whether we can find it in other ways. The most obvious way is in the equity presently held by housing associations in properties that are listed in the accounts at a relatively low value because they are listed at their net present value—they are listed at their income value rather than their vacant possession value. In the main, housing associations want to continue to provide rented homes, but if we can use some of that trapped equity and turn it into cash by trading, that will create potential. So the business model is rapidly changing before our eyes.

Lord Forsyth of Drumlean: I do not understand that. By trading, do you mean selling them?

David Orr: I mean by selling.

Lord Forsyth of Drumlean: But would that not make the problem of providing housing in central London and other places of high value more difficult?

David Orr: If you have a property that you can sell for £500,000 and you may have borrowing against that property of £150,000 or £200,000, then you have £300,000 that you can use to invest in new supply. So there is a timeline gap.

Lord Forsyth of Drumlean: I understand that point, but if it is worth £500,000 it is likely to be in an area where you have most pressure in trying to provide social housing. With your £300,000, which is over and above the written down cost in your accounts, you will not be able to replace it in the same area, so you will move people further out of central London.

David Orr: If you look at the sums, if you can find the land, expensive though it might be, it is possible to provide in high-value, high-cost locations. The challenge for housing associations is making the decision between whether you re-provide a small number in high-value, high-cost places or a bigger number in lower-value, low-cost areas. I do not think the answer to that is obvious. That is quite a challenging debate.

David Montague: From a slightly different perspective, housing associations are very attractive in terms of bond investors—people like to invest in housing associations. We can raise the capital to invest, it is not a lack of capital that prevents us from building more homes. Having said that, I agree with David that, of course, we could do more with public subsidy.

The Chairman: The Homes and Communities Agency, using data from the global accounts of housing associations, estimated that from 2015 to 2019, there will be 285,000 new units, not 375,000, which is the 75,000 a year. They have a graph that shows that, in fact, the number drops from 75,000 or 76,000 a year in 2015 down to 40,000 in 2019. That is based on data provided by the housing associations. That seems to fit rather oddly with your comments.

David Montague: I have not seen the data but I would imagine that is about the pipeline. There are homes that are coming out of the ground and if we build up that pipeline it will reduce over time. But there is also capacity within our balance sheets to do more and I think that that is what David is talking about.

Q114 The Chairman: You anticipated my follow-up question, which is that you are not constrained by the lack of finance in what you can build and what you want to.

David Montague: Certainly not from a London perspective. There is a wall of finance that wants to invest in housing in London. For us, it is about access to opportunity, access to land and access to skills.

The Chairman: I think what you are saying is that to attract that money you have to change the mix of your housing.

David Montague: That is correct, and we are doing that. So 50%, or 60% now, of what we build is either market rent or market sale and the profits that we make fund affordable housing. We have a model that works very successfully and which is tried and tested. We can do more of it but we need the land to do it with.

Q115 Lord Griffiths of Fforestfach: That leads on to my question. If you wanted to provide more low-cost homes, what reforms would you suggest should be made to the planning process?

David Montague: Perhaps I could try to answer this, although I am sure that the others have plenty of ideas. I have a small number of ideas—housing associations, housebuilders, local authorities, together, have a responsibility for promoting the benefits of housebuilding. At the moment, the voice of opposition is often heard more loudly than the voice of support. We need to find a way of incorporating the voice of those people—and the communities—who will benefit from new housing.

Where local authorities struggle to deliver, the urban development corporation idea might have some role to play. In the same way that there are time restraints up to the receipt of consent, there should also be time limits post-consent for Section 106 agreements for all the post-application conditions that need to met. They tend to go on for rather a long while and, if we could focus on sorting out those things sooner rather than later, we could build a lot sooner.

Lord Griffiths of Fforestfach: I would love to hear from the others, but what would particularly accelerate that process? Is there a lack of resources within the planning system to deliver? If we had more people working on it, could we have a quicker delivery?

David Montague: Yes, local authority planning departments are underresourced and there is also a lack of focus on delivery post-consent. Between us, we need to sharpen up that post-consent part of the process; it can often take a year before you can actually lay a brick after consent.

David Orr: The whole thing takes far too long. If we could find a way of speeding up the delivery of planning consent it would make an enormous difference. I have often thought that, if, after a period of time has elapsed, you do not have planning consent, it should be deemed granted. That would speed things up quite a lot. Planning departments are under pressure; it is not just about the officers.

I have been in rural Shropshire today, helping to celebrate a new development by a small rural housing association. I was talking to a farmer there who has a site that could have 32 homes on it—in that area that would make a huge difference. She was extremely frustrated that one member of the parish council has been digging her heels in and it has now gone to the Secretary of State. We have to find ways of being able to stop that kind of institutional sloth being introduced into the process.

Ian McDermott: I would distinguish between two issues: the supply of land and identification of sites within local sites, which I think is the bigger challenge, and the planning process itself. Outside London, we find that the planning process is not that bad, it takes three or four months to get through the planning process. It is much more of a challenge in the capital than it is elsewhere.

Q116 Lord Lamont of Lerwick: We had evidence last week from the private housebuilders. They said that the introduction of the plan-led system, which I understand happened in 1991, had caused a serious impact on housebuilding, with local authorities rationing control of land. They said that the pre-1991 system where, as they explained it, the onus was on private developers to seek out appropriate land for building, was preferable. Do you have a view on that change in 1991?

David Montague: I cannot say that I am expert on planning in 1991. Our preference would be that a 10-year supply of land was identified in advance, which seems to go against what the housebuilders are saying. If we were guaranteed a supply of land, if we knew where it was for the next 10 years, we would gear up to deliver. We would employ the apprentices and we would invest in homes growth and so on. It is the certainty that would support us.

The Chairman: And that would be identified in the local plan. Is that what you are saying?

David Montague: Yes.

Lord Layard: Do you think that local authorities would be more willing to supply land and to give planning permission if there were some sort of simple system whereby they got more of the planning gain when they did it, so that they would have a financial incentive that would help them to answer the critics in the local area?

Baroness Blackstone: May I ask a supplementary question? How far do you think Section 106 provides that very incentive to get agreements and give planning permission for housebuilding?

David Montague: Section 106 is an important part of ensuring that affordable housebuilding so we increasingly rely on it. Although we are unsure about how the introduction of the starter home initiative will affect affordable rented housing, so there is a question mark over the effectiveness of Section 106 going forward. I am sure that local authorities—

Baroness Blackstone: Do you mean because the Government are changing the policy?

David Montague: Yes, because the starter home initiative will count as affordable housing and it is likely, although we await the details, that starter home initiative homes will be top-sliced and then there will be a viability test applied to the rest of the site. If that is the case, it will make it harder to produce affordable housing as part of what remains—though I stress that we have not seen the detail yet.

Local authorities could be incentivised to provide and you have suggested one way; another might be that they retain a stake in that land and enjoy—or share—the long-term rewards of investment along with the housing associations and housebuilders.

Q117 Lord Lamont of Lerwick: I am in no way against Section 106. I see its importance, but is it not correct to say that the reduction was made because the Government, having talked, consulted, and looked at the situation, came to the conclusion that the way it was being applied was holding back the housebuilding programme and industry and that was why they had to make the change? Surely it is important to recognise that.

David Orr: That is a contentious proposition.

Lord Lamont of Lerwick: It is the Government's view, is it not?

David Orr: There are many developers, even among the larger ones, who will tell you that a Section 106 consent and an affordable housing obligation gives them certainty in the sale of a significant proportion of what they build and it cash flows some of the early part of the development. Some of us were frustrated by the level of consultation and debate. The introduction of the starter home as an affordable product in planning terms, which will in practice be there before anything else, will get first priority. That, added to an obligation on planning authorities to ensure that they deliver starter homes, whether or not within their own plan they think that that is helpful, is going to make it more difficult to deliver shared ownership or social rented housing under Section 106. It has been a fairly successful mechanism which is being changed without proper consultation and consideration.

The Chairman: Can you give us some idea, from your experience, of the amount of the gain in value from permissioning that is taken up with Section 106 obligations? Is it a quarter or a half? Do you have any sense of the amount of the gain in value captured by Section 106 and infrastructure levy arrangements?

David Orr: It varies, and it is the subject of gaining, so it is very difficult to put a figure on it. It has been reducing. It is maybe around 25% at present. It has been more; it has been less. It is very much a case of sticking your thumb in the air.

The Chairman: Would you recognise that level of capture of the increase in land value?

David Montague: I am afraid that I do not have those figures with me. I would have to look at them.

Ian McDermott: My sense is that that sounds about right but I would want to go away and check those figures before committing to them.

David Orr: We shall do likewise and, if we can find something solid, we will send it to you.

The Chairman: If you could, that would be very helpful.

Q118 Baroness Wheatcroft: The right to buy in relation to housing associations came as a surprise to some people when it was first announced by the Chancellor. I think that you, Mr McDermott, and indeed the Federation, are largely in favour, but what do you think the effect of this will be? Is there not a degree of unfairness to those in private rented accommodation, who will not get the benefit of buying at that sort of discount?

Ian McDermott: I think that you can distinguish between the propositions of right to buy, one of which is the economic one. Selling assets at full market value does not seem to me terribly controversial, and certainly Moody's and Standard & Poor's, the credit rating agencies, judged independently that it brings a credit positive to housing associations. So as an economic proposition, it seems to me that that is fine. In terms of it as a piece of public policy, we accept that that was the wish of the democratically elected Government, so we accept it for what it is and we can make it work, whether or not it is a good thing. I would also distinguish between the policy of the right to buy and the funding of the right to buy, which we do not necessarily support.

Baroness Wheatcroft: by the sale of council houses?

Ian McDermott: Yes.

Baroness Wheatcroft: Do you believe that the replacement homes will be built as we are led to expect they will be?

Ian McDermott: We will certainly build them, and in fact in our key local authorities we are offering to replace homes that are sold under right to buy by other non-developing landlords. So we are working closely with the local authorities and making our offer very clear with them. I think there are challenges in particular local authorities. To go back to the example that I gave earlier, Westminster is particularly challenging. Replacing any stock lost within Westminster will be very difficult. Elsewhere it will be much easier, but our ambition is to replace within the local authority and to work with the local authority on that replacement.

Baroness Wheatcroft: Mr Montague, are you sanguine about this?

David Montague: We support the voluntary deal that the National Housing Federation negotiated. We think that, certainly compared to a statutory deal, it is better for housing associations, better for housing association tenants and, in the long term, better for social housing. Like Sanctuary, we are less positive about the way that it is funded, but at worst it is neutral in on L&Q's finances and we will make it work. The sector as a whole is committed to one-for-one replacement as part of the voluntary deal.

David Orr: I am completely certain that one-for-one replacement will be delivered and, with a fair wind, it might be better than that. However, although, as colleagues have said, we negotiated the voluntary right-to-buy deal, and I am very pleased that we did, we negotiated it from a position where the Government had made it very clear that there would be a statutory right to buy and it would go through Parliament. Critical in negotiating that deal has been ensuring that any selling housing association gets full vacant possession value, and that will be the case for the first time in the 35-year history of right to buy.

Wherever the Government get the money, it is not a particularly efficient or fair use of public subsidy. It was absolutely right that we negotiated the deal, and there is sufficient flexibility in it that it should be able to work for the majority of people. However, you asked why it would be axiomatic that it is okay for the person living on my left-hand side in a housing association home to get a £70,000 discount while the person living in private rented housing on my right-hand side gets absolutely nothing. There is a political question to be asked about that.

Baroness Wheatcroft: But you said that that was not an issue for debate at all.

David Orr: It was not an issue for debate.

Lord Turnbull: I have a question regarding one-for-one replacement. This relates to you and the housing associations. You say that you can replace the properties that you sell, but there is also the sale of properties by third-party councils. Will they also be able to achieve one-for-one replacement? Both parties to this scheme that are selling but, overall, are they going to be able to achieve one-for-one replacement?

David Orr: That is difficult for us to say. We do not have the same access to the values of local authority housing stock as we do for housing association stock. The commitment that we made as part of the deal for one-for-one replacement is that if 10,000 homes are sold, 10,000 new homes will be built. That is all. We did not say where, in what geographies and in what tenures, because delivering that would be incredibly restrictive. The truth is that if Westminster or Kensington and Chelsea manage to sell vacant properties, they might generate quite a lot of income from that.

One of my big anxieties about the right-to-buy deal is that, with a housing association operating in a low-value area, the discount is going to make the purchase extremely affordable. Some people will have to find £15,000 or £20,000 and no more to buy their home. Even if it is sold at vacant possession market value, if the amount is £50,000 or £60,000 an association will not be able to replace that home. There is a real danger that good-quality social housing will diminish, particularly in those low-value areas. So there is a challenge for us collectively to work out how we deal with that. It will be easier in high-value areas to generate the income that allows new supply if you can access the land.

Baroness Wheatcroft: Mr Montague, I was interested in the point about Westminster, but the replacement housing is likely to be in much less desirable areas.

David Montague: That really depends on the effectiveness of the partnership that we create with local authorities. G15, the group of the 15 largest housing associations, has just made a new offer to London in which we are committing to 180,000 new homes, but that has to be done in partnership. Together, we have to deal with a shortage of land. If local authorities and the GLA together can guarantee a pipeline of the right land, we can guarantee new affordable homes. Together, the G15 group has committed to protect social housing in London, and that is housing association and local authority stock combined.

Lord Forsyth of Drumlean: Why did you agree to this deal with the Government?

David Orr: We could have fought it and said that we think it is a bad idea and does not bear close examination.

Lord Forsyth of Drumlean: Which is what you think.

David Orr: I would be very happy to go on the record to say that I think a statutory right to buy imposed on housing associations would have been a bad thing. It is fundamentally wrong for the Government to determine what stand-alone, private, social enterprises may or may not do with the assets that they own. That is a decision that purely and solely should be reserved for their boards. We negotiated the deal to retain that potential, so it is the boards of housing associations that will determine whether a property is sold. The fact that we were able to negotiate a deal where the property is at full market value sale means that most housing associations in most places will be able to generate cash that will allow them to build more homes. So there are opportunities, but the critical thing is that the decision still rests with the housing association.

Q119 Lord Forsyth of Drumlean: It is years—a lifetime—ago that I was on Westminster City Council, in the 1970s. In those days a flat in Eccleston Square cost, I think, £15,000; it is now £750,000. We struggled as a local authority to find housing for key workers—for nurses, porters and other people—in central London and that problem must now be greatly exacerbated. We relied on Peabody and a whole range of other organisations. Listening to the evidence that has been given, it seems both ends are showing difficulty. If you sell high-value properties, replacing them in Westminster is going to be a problem and, of course, you are going to lose properties in less expensive areas, as you have just described.

Unless you are alchemists, I do not see how you are going to be able to serve the community that you are meant to serve, which is people who need housing at a price which they can pay their rent. Although you say you can do it, and although you will be taking the decisions, will not the decisions that you are taking ultimately result in less supply of the kind of housing that you are in business to provide?

David Orr: If I had a straight choice between the Government providing £2 billion to provide discounts to allow people to trade social rented housing or to use that subsidy to build new homes, I would choose to use it to build new homes.

Lord Forsyth of Drumlean: So what would the effect of that be?

David Orr: If we were using that £2 billion as a means of helping people into owner-occupation through shared ownership—I will have to check the figures—we could honestly build hundreds of thousands of new homes. The total amount of subsidy required to make shared ownership work in most parts of the country is very small, but it gives people a stake in their home and it means that they would be asset holders and, therefore, on the property ladder. That option, however, was not presented to us. The option that the Government presented was a clearly stated commitment to legislate for the right to buy. It is not just that the legislation would have required housing associations to sell even if, strategically, they thought it was a bad idea, the legislation had the potential, at least, to change charity law and no longer to require the sale of charitable assets has to be covered by the full market value.

This is not a comment about this Government at this moment, but the statutory obligation to sell would have been written into law. The provision of the discount at that level would almost certainly not have been written into law, so we might have found ourselves in a position 10 years hence where there was still a requirement to sell, even though the discount money was not forthcoming. There are far too many dangers attendant on that.

Baroness Wheatcroft: Had there been any element of consultation or any hint of this coming before it was announced?

David Orr: None. The announcement of the right to buy being extended to housing associations was made in the Conservative Party manifesto. It was the headline issue in the press release that accompanied the launch of that manifesto. I had heard two or three days in advance that this was being considered—I am obviously not a very competent lobbyist because I tried to persuade them to do otherwise and failed. But there was no consultation with the sector; until the point at which we began to talk to the Secretary of State about a voluntary arrangement, there was none. That was the point at which a conversation started.

I want to address your question, Lord Forsyth, about the alchemy. Many, many housing association homes are valued at existing use value for social housing. It is about 35% of their market value. If you sell at market value, there is actually quite a big gap between the book valuation and the real valuation—the cash that might be achieved. In many parts of the country, though by no means all, the passage of time and the fact that property accrues in value in almost all circumstances means that there is considerable asset value which is tracked if you regard the property as something to be held for rent in perpetuity. That has been both the government and sector view for 35 of the last 40 years. The change has come very recently. We are all trying to recalibrate this and rethink the model. But the combination of being able to build for sale and for market rent and the ability to tap into some of that tracked equity has the genuine potential to release quite a lot of investable cash. I think it is possible, but it is almost inevitable that the pattern of provision will change and that we will see more shared ownership as new supply and less social rent, and we will see more in lower-value areas and less in higher-value areas. Though I think that there remains a real commitment by both local authorities and housing association to ensure that there is social housing for rent in high-value markets in London and elsewhere.

Q120 Baroness Blackstone: Policy Exchange has suggested that there are too many housing associations and that this leads to inefficiencies. I suspect I know what you will say but, nevertheless, I want to ask the question: whether to do all the things that you have just been describing, which is a complex set of decisions that have to be taken by housing associations on the balance between new housing for market rent, for market sales, for affordable housing for rent, would it not be better if there were some mergers and acquisitions? There have been some, but would it not improve the number of houses being built and make the decision-making a bit easier, because larger organisations are more likely to have all the resources needed to take these difficult decisions, rather than sticking to the very long tail of extremely small housing associations that we have at the moment?

David Montague: The diversity is one of the sector's strengths. Having said that, the combination of rent reductions and right to buy has triggered a wave of consolidation, the likes of which we have not seen before. We will see much greater consolidation in the sector over the coming years—it is already happening. There is a great deal that consolidation can offer. Larger associations can shoulder risks that smaller associations perhaps cannot and they can attract capital in a way that smaller associations cannot. But small associations have something to offer as well and it would be a shame if we were to lose that diversity completely. There is a great deal more that we can do and, regardless of whether we consolidate, the sector is keen to do a lot more. The greatest risk is that we get distracted as a result of consolidation and spend the next few years talking about systems, processes, culture and that kind of thing, rather than homes.

Ian McDermott: Could I just say that the answer to your question is almost certainly yes—nobody would design the system that we currently have for the provision of housing, it would not make sense. Last year, Sanctuary built more than 3,000 homes, the equivalent of two average-sized housing associations. We certainly did not add to our cost base the costs that would be associated with two average housing associations.

There is a tendency to look at the sector and all the organisations as an amorphous mass but the truth is that a lot of the bigger associations are doing all that they can to maximise their capacity and to contribute towards the provision of housing overall and there are lots of smaller associations that are doing some interesting work. But there are associations that are not using their capacity; the trick is not to brand the whole sector as either inefficient or efficient but to be more strategic and specific in identifying those associations that are perhaps not doing their fair share of heavy lifting.

Lord Turnbull: Am I right in thinking that the sum total of all this is that the rent control, the right to buy, and the way that your own business models are developing—you have managed to reconcile all those? The bit that I am not convinced about is that, in my view, the point of greatest social pressure is in the rented sector, where the affordability problems are greatest. That is the bit that will suffer; you may achieve one-to-one, but it will not be one-to-one of the same mix of tenure, I think you were saying. The tenures that are probably more attractive to people who are slightly better-off but not rich are the things you will be moving to and we will be leaving untreated, and possibly worsened, the problem of the poorest sections of the community and the rents that they have to pay.

David Orr: I have been regularly asked in the last few months, given all the changes that the Government have made, whether it means that the mission of housing associations has to change. The answer to that question is no, it does not mean that. But it does mean that the various changes that the Government have made makes the delivery of the mission much harder.

Housing associations will remain—and do remain—committed to that core, central provision of good quality, affordable housing for people on low incomes, which has been supported to a greater or lesser extent by Governments of the left and the right ever since the 1974 Housing Act introduced housing association grant. It has gone now. This Government want to use the housing investment money that they have to support people in owner-occupation. That is a political decision that they are entirely entitled to make, but housing associations will have to use the assets and resources that they have to try to continue delivering a product that, for 40 years, has been supported by upfront capital investment from the Government. Is it going to be more difficult? Yes it is. Will there be less of it than we would want? Yes there will. But it is absolutely clear that the delivery of new, affordable rented homes will continue.

David Montague: I agree with everything that David has said. We have seen a pivotal shift away from renting towards home ownership. All the incentives focus on home ownership, all the disincentives focus on housing for rent. The average L&Q tenant earns £14,000 a year and, even with a £100,000 right to buy discount, the vast majority of our tenants will not be exercising their right to buy. As a charity, our main focus is on provision.

Lord Turnbull: Would you say then that the area of social pressure, or social harm, which is most acute is the one that is being least well addressed?

David Orr: I think that you could argue that case. Right now, today, the area of greatest pressure is the provision of supported housing for people who are vulnerable and who need support to be able to live effectively in the community. In the comprehensive spending review, the Chancellor announced that social housing rents would be eligible for housing benefit only to the level of the local housing allowance cap. If that is indeed the case for supported housing, then we will lose half the supported housing in the country.

I was at another event recently where I described this as another example of an introduction of flamboyant uncertainty. The Government have studiously refused to say whether they intend it to be for supported housing. They say that they want to protect supported housing; they could clarify their position by saying that the cap refers to people of working age in general needs housing and everyone could breathe a big sigh of relief. As we are today, however, because of that decision and that announcement, new supported housing schemes that were due to go on site are being pulled; they are not going ahead. People are negotiating new support contracts and they are unable to do so because they do not know what their future income stream is. If the Government and the nation want housing associations to make the best contribution that they possibly can, avoiding introducing such areas of uncertainty without consultation would have a considerable impact.

Lord Turnbull: We have also heard from McCarthy & Stone about the elderly—we are getting older but the process of recycling properties is slowing down. There are various sorts of fiscal incentives—such as house prices rising—that mean you delay that. Are you finding that this area, because providing that kind of accommodation is more complex and has higher costs, is also being sacrificed?

David Orr: There has been a significant—and welcome—growth in the last few years in extra-care retirement villages. It is accommodation that is much needed and very welcome. In fact, in some of those extra-care retirement villages, the introduction of a shared ownership offer has been incredibly welcomed, because people who are cash-poor but asset-rich can downsize and release a whole lot of cash from selling their home but retain an investment in the property. If you are targeting that market at people who are wealthy enough to be entirely self-funding, then that works. It also worked until recently for people who have some reliance on housing benefit, but the LHA cap decision means that extra-care retirement villages are not going on site because of the uncertainty that has been introduced.

If we are to look at the provision of housing in the round, one thing that housing associations and colleagues in voluntary organisations in the care sector and in local government have done quietly and extremely well is the provision of supported housing in the community. That is under severe threat.

David Montague: The provision of older people’s housing is supported and encouraged by the NPPF and by the London Plan. As a large charity we think that we have a responsibility to provide for older people. It is far more uncertain at the moment than it has been in recent years, so we are going to wait and see what the outcome is of the current discussion around LHA and rent reductions.

Baroness Blackstone: What do you think will happen to these vulnerable people if housing associations are no longer able to provide supported housing for them, as they have done for many years?

David Montague: I guess that the responsibility will fall to local authorities through the social care budget.

David Orr: And provision that does not exist.

Baroness Blackstone: Yes. Local authorities do not have provision for these sorts of people. Presumably they will be homeless on the streets.

David Orr: This is provision for people with learning disabilities, people with autism, people who have been drug or alcohol users and people who are fleeing domestic violence—a whole range of people who for whatever reason at this point in their lives need some support to live in the community. If you have a form of autism that means that your behaviour is extremely difficult to manage and you are living in a housing association property with a separate organisation providing care—there are a number of examples of this—the rent reflects the cost of that provision. It does not reflect the market; it does not reflect what is happening in the private rented market for young professionals; it reflects the cost of delivery. That might be a rent of £185 a week which is presently covered by housing benefit. If you are under 35, you will be entitled only to the shared accommodation rate, which might be £60. I am thinking of a specific project here and that project will close if this measure is introduced. The cost of residential care for people in those circumstances might be as much as £50,000. The cost to the state of doing this will be vast, not to mention the cost to the individuals who will be affected by it.

Q121 Lord Turnbull: That relates to my last question. What is this ONS dispute all about? Why did they do the strange thing of reclassifying you as being in the public sector? The Government agree that you should not be there and you do not want to be there. Your memorandum welcomes the Government's commitment to doing this. What needs to be done to sort this issue out and how much damage is it doing?

David Orr: The short answer is that a whole range of deregulation measures need to be legislated. These deregulation measures have been introduced in the Housing and Planning Bill and, with any luck, they will get Royal Assent some time in the next two or three months. The ONS will reconsider and come to the decision that we all hope it will, saying that of course housing associations are private bodies.

Lord Turnbull: The reason it has given is that it thought that the state had too much influence over these matters.

David Orr: Indeed. That is the basis of the classification decision. At various points in the past, the state in one form or another has sought to interfere to a greater or lesser extent. Although the timing was not helpful, the decision is helpful because it clarifies precisely where we are and it will allow us to deal with the problem.

Lord Turnbull: Is it doing any harm at the moment?

David Orr: In the short term, no, but if it does not get fixed very quickly, it has the potential to.

Ian McDermott: Perhaps I may add one thing, which is a comparison between the regulation in Scotland and that in England. In Scotland the rent charged by housing associations is not a matter for the regulators; they are free to set their own rents. You might therefore assume that rents are high, whereas in fact they are lower. One area where Sanctuary would like to see deregulation is that of allowing landlords to set their own rents. I know that this was partly to do with housing benefits but there are other ways in which the housing benefit bill can be controlled. Allowing housing associations the freedom to set their own rents will add to the overall capacity of the sector and enable us to add more value to the economy.

David Montague: Housing associations borrow something like £5 billion a year. Naturally we would be concerned about how that borrowing would be treated if this problem was not resolved, but it seems that it is being resolved.

Q122 The Chairman: Mr Orr, has the federation made a forecast of the impact of all the measures on the supply of social housing for lease and supported housing, and the extent to which it will decline over the next five years?

David Orr: It is quite difficult to do any accurate forecasting because there are too many moving parts at the moment. In regard to supported housing we have done some analysis of what the impact might be if the LHA cap is imposed in the way that in bald terms is proposed at present. We have a briefing on that which we could make available to your Committee.

The Chairman: That would be helpful. Looking at your forecasts for your organisations over the next three, four or five years, to what extent is social housing for rent and supported housing declining as a percentage of the number of units that you will build?

David Montague: I mentioned earlier that we have a 50,000 home programme. Prior to the Budget, 50% was social housing; post-Budget, 40% is social housing. We are going to do our best to get back to 50% but we are going to have to fundamentally change the way we do things.

Ian McDermott: For us, it has changed significantly. Historically, the majority of what we provide has been social rent or affordable rent housing. Going forward, it will be shared ownership and affordable home ownership. So the balance has changed quite fundamentally.

Lord Layard: I want to come back to the land shortage point that you raised before. What kind of land do you most want to get your hands on that you do not currently easily get your hands on? Were you talking about brownfield sites inside existing built-up areas or greenfield sites or even green belts? Can you say anything about where you want to put houses but are having difficulty in doing so?

David Montague: Our preference would be brownfield land. In London there is the capacity for 400,000 homes on brownfield sites. We can do a great deal more in London. We think that the NHS and the MoD need to look more carefully at their land holdings. We could do far more with that land. It strikes me that the NHS has a health crisis; we have a housing crisis. It has land; we have money. There is a lot that we could do together. It is about managing more effectively the land bank that exists within the public sector.

Lord Layard: This is what we ask you at the end. What one thing would you change in order to enable housing associations to build more houses?

David Montague: For me, it would be access to land. If we can be guaranteed a 10-year supply of clean, serviced, consented land, we will guarantee homes, apprenticeships, economic growth and jobs.

Ian McDermott: David has just stolen my answer. I guess that it would be greater freedoms and flexibilities to run our own business as we think fit. As organisations, we are in a different position from that of private developers. We are able to plan for the medium and long term. We work at quite a steady state and can operate throughout the different cycles of the development. Having long-term access to land sites and allowing us to provide those numbers over a sustained period will be the most important thing.

David Orr: In addition to my two colleagues, I think that government has to get out of rent setting and leave housing associations to be properly in control of their own financial affairs. The impact of government involvement in rent setting has been that we have a complete shambles. When you look at the extent to which the Government are controlling the impact on housing benefit through the measures they are taking, there is no justification for them to be involved in rent setting.

If I might add one word of warning, the new model for delivery and for using the commercial potential of housing associations to generate those surpluses means that they are very dependent in a way that housing associations have never previously been on what is happening in the market. In the past, where there has been a market collapse, the availability of grant has allowed housing associations to keep on building. If there were a market collapse in two years' time, that would no longer be the case.

The Chairman: You are more at the mercy of the market.

David Orr: We are at the mercy of the market.

The Chairman: On that slightly uncomfortable note, thank you very much indeed for joining us this afternoon.