

**State of the nation
2008: a reality check**

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State of the Nation 2008: a reality check

This State of the Nation review discusses how policy and economic events over the last year have impacted on the affordable housing sector in Scotland. The review is informed by soundings taken from 12 directors and chief executives of Scottish local authority housing services and housing associations, and private sector residential agents.¹ The theme of this review is 'efficiency – theory and practice' explored in three main areas: housing supply and the credit crunch; regulation and governance; and the government landscape.

Key events over the last 12 months

- September 2007 – signs of the credit crunch emerge as Northern Rock collapses
- September 2007 – Crerar review published
- October 2007 – *Firm Foundations* consultation and abolition of Communities Scotland announced
- November 2007 – Spending Review announced including information on the performance framework, Single Outcome Agreements and the Concordat agreement
- March 2008 – housing need and demand guidance published
- April 2008 – *Firm Analytical Foundations* Scottish Government conference
- April 2008 – Communities Scotland abolition and creation of Scottish Housing Regulator
- April 2008 – Consultation on Housing (Scotland) Act 2006: private sector housing quality
- May 2008 – publication of guidance on Strategic Housing Investment Plans
- June 2008 – publication of SHR regulation plans for housing associations
- June 2008 – publication of Local Housing Strategy guidance
- June 2008 – consultation on proposed changes to homelessness legislation: use of non-permanent accommodation
- July 2008 – publication of SPP3: *Planning for Homes*

¹ Only the key themes from the consultation are reported to safeguard anonymity. A spread of local authorities and RSLs were consulted in terms of geography, housing markets and developer/manager RSLs

- August 2008 Scottish Government *Responding to the Changing Economic Climate: Further Action on Housing*
- September 2008 – the credit crunch is in full swing as Lehman Brothers fall and between September and October rescue plans for the global financial markets are put in place
- October 2008 – Home Report publicity campaign: from 1 December all homes sold require report
- October/November 2008 – Bank of England confirms UK is in recession.

Housing supply, procurement efficiency and the credit crunch

September 2007: the crash of Northern Rock and the first clear signs of the credit crunch. Less than one month later the Scottish Government published its ‘ambitious and radical’ proposals in *Firm Foundations: the future of housing in Scotland*.² The Government has placed an emphasis on increasing housing supply: from approximately 25,000 to 35,000 per annum across all tenures by 2015, arguing the importance of increasing housing supply as a means of improving affordability in the medium term. There is no separate target for the affordable housing sector, although there is a requirement to increase ‘value for public expenditure’ in its delivery.

HAG reform

Consultation responses generally welcomed the target for increased supply, and there was some cautious support for a ‘strategic and competitive approach’ to the allocation of subsidy to increase value for money.³ Regardless of the strategic and competitive theory, in practice the Scottish Government announced a 15.6% reduction to the Affordable Housing Investment Programme (AHIP) quickly followed by amendments to the Housing Association Grant (HAG) assumptions. The aim of this change has been to cap the average amount of grant per unit to a target of £73,000 from an average of £79,000 per unit in 2007.⁴ The context is a 35% increase in average unit grant levels over the last five years: the Scottish Government considers this as unsustainable, although at the same time states it ‘can probably be attributed to inflation in the construction industry and in the price of land’.⁵ This was confirmed by research undertaken by the University of Glasgow on social housing development costs,⁶ which concluded grant levels were driven mainly by market forces and planning policies: land cost increases; land decontamination costs; possibly section 75 requirements; but also housing association policies including low rent increases and inefficient scheme-by-scheme design practices. The university’s conclusions led to recommendations around strategic procurement and scale efficiencies,

² <http://www.scotland.gov.uk/Resource/Doc/201716/0053780.pdf>

³ <http://www.scotland.gov.uk/Topics/Built-Environment/Housing/FAF08/ResponsestoFF>

⁴ Firm Foundations, <http://www.scotland.gov.uk/Topics/Built-Environment/Housing/investment/guidancenotes/hstbenchmark>

And <http://www.cih.org/scotland/policy/Housing-Supply-July2008.pdf>

⁵ Firm Foundations

⁶ <http://www.scotland.gov.uk/Topics/Built-Environment/Housing/FAF08/CostofNewSocialHousing>

but provided a note of caution over seeking higher rents and constraining allowances in an effort to reduce subsidy levels. It is therefore perhaps not surprising there was almost unanimous dissent over the sudden change in HAG subsidy assumptions in advance of more substantive conclusions on the strategic and competitive approach to affordable housing procurement.⁷

Lead developers

Of course the policy drive for increased supply combined with procurement efficiency agenda was planned well in advance of the financial and housing markets crisis. Acknowledging the unprecedented market change, Stewart Maxwell, Communities Minister, recently voiced uncertainty over when the 35,000 per annum goal may be achieved but wishes to continue using the target as a motivational tool. However, he has given no indication of the let up in the efficiency drive, and indeed he confirmed that: ‘*..the basic problem in Scotland is an under-supply of houses and we can’t eradicate that under-supply by building less houses for more money*’ and in terms of lead and regional developers: ‘*..the number of overall developers will fall substantially*’.⁸

Discussions between the Scottish Government and COSLA on the regional developer approach have now reached the point where proposals were due to be issued for consultation at the end of November or beginning of December. This follows the roadshow of regional seminars undertaken earlier in the year where the Scottish Government took soundings from attendees on how such a system may work. Consultation with housing associations and local authorities undertaken as part of the review suggests it was very much a listening exercise which on the one hand was welcomed, whilst on the other there was some scepticism over the ability to develop realistic proposals, and the timescales involved in both policy development and implementation. There are also concerns from smaller and rural authorities where it is more difficult to mass procure. Although unlikely to be implemented in 2009/10, Scottish Government performance to date suggests the change will be driven through regardless of how unpopular it may be.

The theory behind regional procurement broadly follows the CWC’s *Recommendations for a National Procurement Strategy for Social Housing in Scotland*⁹ which sets out how to ensure more collaborative working for social housing development programmes to improve value for money. The theme is continued in the University of Glasgow study (as noted above) which suggests that the case for securing economies of scale through lead development and larger partnered construction programmes requires lessons to be learned from previous procurement strategies, and for the programmes to be multi-year in duration to offer opportunities to share risks and savings. The same set of recommendations also argues that larger and stronger housing associations with low debt, good management and strong boards should be able to use their asset base through refinancing to lower subsidy costs: it also suggests some associations will be able to use reserves creatively. The authors may now reflect upon the conclusions on refinancing given the recent and rapid change in the credit markets.

⁷ <http://www.scotland.gov.uk/Topics/Built-Environment/Housing/investment/bettervalue/bettervalue>

⁸ Inside Housing 7 November 2008

⁹ Smalley M, Jarret N, and Baldwin J, CWC, January 2007

In practice there is little actual experience of lead developer status in Scotland: the six Larach partners have tested a number of elements of modern methods of procurement including partnering principles, utilising standard house types and specifications, and has provided an opportunity to incorporate involvement in training initiatives through their housing developments. Of course, many other housing associations would argue they have delivered the same through their individual programmes. Perhaps further down the path, Devanha in the North East is now established as a company from six housing associations through which the majority of HAG funding is passed in the region, and a four-year Scottish Government evaluation will establish to what extent efficiency savings in procurement (and other benefits) will be achieved.

What about the real world?

Meanwhile, as all this policy development and consultation was underway, what was happening in the 'real world' this summer? September figures showed that UK house sales had dropped by 50%, and in Scotland by 42% when compared to the same time last year.¹⁰ Cancellations on new home reservations have been as high as 40% in some developments.¹¹ House prices in the UK overall have been projected by Capital Economics to fall on average by 35% over this year and next, although in Scotland the decrease may be slightly less at 12% this year and another 15% next year.¹² So far, according to the Lloyds TSB house price monitor, house prices have risen by 4.9% in Scotland overall this year – a big reduction on the 9.3% increase reported last year – caused mainly by a large drop in value of 4% in the last quarter to 31 October.¹³ Repossessions in September increased by 71% on the same time last year¹⁴ and various predictions suggest that a full housing market recovery to 2007 price levels will not emerge until between 2013 and 2015.¹⁵ Homes for Scotland suggests that no less than 26,000 redundancies have already occurred in the house building sector¹⁶ and almost every day the press provides evidence of developers writing-down the value of their land assets amid the deteriorating trading conditions. According to two residential agents the worst is probably still to come for some developers/housebuilders: as values continue to reduce some will inevitably go bust at which point the vulture funds (those set up to take advantage of distressed or mis-priced asset) will sell on the repossessions from the housebuilders at even lower prices. Further figures released at the beginning of November suggest the jobless total is at its highest level for a decade, and this does not include the banking jobs shed in September, never mind the expected losses from the major bank mergers.¹⁷ All the analysis indicates the country is sliding into recession and hence the shock interest rate cut of 1.5% on the 6 November and then a further cut less than one month later by another 1% to a 57-year low of 2% with the aim of reducing the risk of a long and deep decline.¹⁸

¹⁰ *The Herald*, 22 October 2008, and <http://www.ros.gov.uk/aboutus/news.html> 13 November 2008

¹¹ *Scotsman*, 28 October 2008

¹² *Scottish Housing News*, 29 October 2008

¹³ <http://news.bbc.co.uk/1/hi/scotland/7727238.stm> ¹⁴ <http://news.bbc.co.uk/1/hi/business/7694819.stm>

¹⁵ <http://news.bbc.co.uk/1/hi/business/7692814.stm> and consultation with two private sector residential agents

¹⁶ *Evening News*, Jonathan Fair, Homes for Scotland, 3 November 2008

¹⁷ <http://news.bbc.co.uk/1/hi/business/7672198.stm>

¹⁸ <http://news.bbc.co.uk/1/hi/business/7713006.stm>

Rescue packages

The Scottish Government's response to the crisis has been two announcements in June¹⁹ and August.²⁰ Firstly in June, a home-owners' support fund of £25m, and the expansion of shared equity schemes backed by investment of £250m over the next three years was announced. The commitment to the 35,000 supply target was reiterated (now softened through an announcement from Stewart Maxwell) as was its determination to remodel affordable housing delivery. August saw more support which was targeted towards the housebuilding industry: bringing forward £100m of the AHIP to accelerate building of affordable housing, but also setting out criteria for funding the purchases of unsold stock or land from developers. Most recently in November²¹ more help was announced for families facing repossession through the extension of a range of legal advice and support available across Scotland to families facing home repossession. Perhaps also as a result of the current housing market conditions, the Scottish Government has brought forward implementation of section 11 of the Homelessness, etc (Scotland) Act 2003: it agreed with COSLA in September that it will come into force on 1 April 2009. This places a duty on landlords (except local authority landlords) and creditors to notify the relevant local authority when they raise proceedings for possession or serve certain other notices. Its purpose is to give local authorities early notice of households at risk of homelessness due to eviction, and the Scottish Government and local authorities will be advertising nationally and locally to raise awareness of the new duty on landlords.²²

Procurement efficiency and the credit crunch – what is the impact?

What does this all mean for the affordable housing sector? Soundings undertaken to inform this review have revealed common and strongly felt views. For the developing associations, the change in HAG assumptions, combined with the efficiency agenda and credit crisis have apparently made for difficult working conditions and some say poorer outcomes. For some housing associations finance is more difficult to obtain and or more costly, and contrary to conventional wisdom, it can be the largest housing associations that feel the impact first: those that go straight to the financial markets. For others there has been a huge sigh of relief as facilities were negotiated in advance of the credit crunch hitting hard, achieving what most would consider now as unbelievably good rates. However, a few have experienced 'bad behaviour' from nervous bankers seeking any grounds for breach of covenant to instigate a review of terms. Finally, some are undertaking major reviews of processes and teams to achieve savings that will be used to service additional borrowing required to develop under the new HAG rules. The result may be more 'very tight ships' but what incentives are there to encourage perhaps more comfortable non-developing associations to follow suit?

Crisis? What crisis?

Based on this sample of housing associations and local authorities the experience of the Scottish Government market rescue package could be better: all queried the transparency

¹⁹ <http://www.scottish.parliament.uk/business/officialReports/meetingsParliament/or-08/sor0625-02.htm>

²⁰ <http://www.scotland.gov.uk/Resource/Doc/1035/0064706.pdf>

²¹ <http://www.scotland.gov.uk/News/Releases/2008/11/21114452>

²² <http://www.scotland.gov.uk/Resource/Doc/161445/0043817.pdf>

in the allocation of funds, although the common view is that those areas benefitting most will be those where the original AHIP cut was greatest. Many have referred to the Scottish Government's inability to respond quickly to opportunities presented by housing associations from developers, including those for mid-market rent despite this being one of the commitments in *Firm Foundations*. But as two housing association chiefs pointed out, the market has probably not hit its lowest point yet and so it is a waiting game to achieve the best opportunity and value for purchasing unsold stock or land from developers. In its defence, the Scottish Government has reiterated that it has done everything it could against the tightest spending settlement from the UK government since devolution.²³

Regulation: are you ready for independence?

September 2007 saw the publication of the Crerar Review, the scope of which was to consider how Scotland's systems of regulation, audit and inspection could be improved. It was commissioned as a key initiative within the wider public reform agenda in Scotland, and no doubt the cost of regulation which stood at £92m in Scotland in 2005/06 was a major driver for a review.²⁴

The five guiding principles recommended from the review were: public focus; independence; proportionality; transparency and accountability. There was a clear emphasis that the primary responsibility for demonstrating compliance and performance should rest with the governing body of service providers, and that over time Scottish Government should rely less on external scrutiny and more on self-assessment by providers. It also recommended that cyclical inspection activity should reduce and only occur where all other scrutiny options have been considered. Perhaps the most challenging recommendation was that there should be some amalgamation of regulatory bodies, eventually culminating in a single national scrutiny body.

The Scottish Housing Regulator

Less than one month later *Firm Foundations* included the announcement of the abolition of Communities Scotland, and the creation of the Scottish Housing Regulator (SHR). The argument for this move was on the one hand around integration of functions to enhance strategic capacity to drive through housing reforms, and on the other to separate out standard setting and measurement.²⁵ *Firm Foundations* also set out ministers' intentions that the SHR should follow Crerar's recommendations for a risk-based and proportionate approach to regulation and where the responsibility for meeting standards, improving performance and achieving value for money should rest with governing body members or elected members.

If anyone was still left in any doubt over the Scottish Government's intentions for regulation, these were reinforced in the Spending Review issued in November 2007. It stated the commitment to a smaller, simpler and more effective government, with fewer

²³ *Inside Housing*, 3 October 2008

²⁴ <http://www.scotland.gov.uk/Resource/Doc/82980/0053065.pdf>

²⁵ *Firm Foundations*, October 2007

public bodies, and set a target to reduce the number of public bodies by 25%.²⁶ The Scottish Government has pushed on with this target: on 6 November 2008, John Swinney outlined to parliament the creation of a single scrutiny body looking at health services, and a single body scrutinising care and social work. The changes announced will reduce the baseline list from 29 to 23 bodies and it is anticipated that the parliament's ad hoc committee will look at opportunities for joining up existing functions which may lead to further reductions.²⁷ In September 2008, SHR's corporate plan repeated the same message '[the SHR will] anticipate and support the objectives the Scottish Government is setting out for a modernised framework for housing regulation. Throughout this plan period we will be working hard to spend our time where it matters most and to bring about real improvement in people's lives through better homes and services'.²⁸

The creation of the Scottish Housing Regulator in April 2008 was quickly followed by the publication of its guide to regulation,²⁹ which confirmed the thrust of the Government's plans, and noted that there could be further change for the housing regulator. For the meantime, it will require self-assessment as an increasingly important part of the regulatory regime, although baseline inspections will still be undertaken for local authorities and newly registered housing associations. The guide also formally introduced the risk-based approach for housing associations and the regulatory plans published later in the year demonstrated which organisations were to be considered under medium and high engagement. A total of 48 organisations are on the 'hit list', of which 13 are categorised as high level engagement and 35 as medium. The table below shows an assessment of the reasons for engagement, the most common reasons being governance, mergers, customer performance and business planning issues.

Theory great... what about reality?

How in practice has the change in regulation been received by housing associations and local authorities? In parts of the housing association sector there are some concerns that the perceived strength of the regulator will be diminished leaving ultimate responsibility with the governing bodies.³⁰ This in turn opens the debate over governance roles, responsibilities and skills in the housing association sector, although not surprisingly many now look at the governance performance in the corporate sector and question whether this is a model to follow. Other feedback from housing associations relates to 'risk' versus 'engagement' where some funders have interpreted the term of high engagement as meaning high risk, which has understandably raised concern, particularly in the current economic climate. This is perhaps a matter of terminology rather than reality, but nevertheless is considered as important by some housing associations.

²⁶ <http://www.scotland.gov.uk/Resource/Doc/203078/0054106.pdf>

²⁷ <http://www.scotland.gov.uk/News/Releases/2008/11/06103757>

²⁸ http://www.scottishhousingregulator.gov.uk/stellent/groups/public/documents/webpages/shr_corporateplan_ia48e1eb1d.pdf

²⁹ http://www.scottishhousingregulator.gov.uk/stellent/groups/public/documents/webpages/shr_guidetohowweregulate.pdf

³⁰ Evidence based on feedback from recent HQN seminars held in Scotland

Reasons for engagement	Number of organisations ³¹
Governance	13
Merger, transfer of engagements, etc	13
New organisation	6
Value for money	7
Financial viability	10
Performance/customer service	13
SHQS	12
Assurance around BP commitments	13

For local authorities, three consultees participating in this review have recently been inspected. There was a unanimous theme that it was a positive experience, that useful lessons had been learned, and that they expected outcomes for service-users to improve as a result. However, two out of three strongly questioned the extent of investigation required to reach conclusions. Indeed, one was able to make a direct comparison with another recent inspection arguing that the focus on self-assessment was much greater and the outcomes equally as useful. It remains to be seen whether the housing regulator will be able to continue with this methodology for the remaining baseline local authority assessments, or whether a streamlined self-assessment approach will be adopted more quickly. Indeed a team has been established within the Scottish Government to consider the future of housing regulation for local authorities, and the role the SHR will take. Informing the outcome of this review will be the recently commissioned research by the Scottish Government into how tenants perceive 'value' in relation to social housing.

Lessons from regulation south of the border

Are there any lessons that can be learned from the regulatory experience in England this year? The obvious one is the Ujima affair. Ujima was a 4,600-unit housing association based in the south of England. It was brought under the Housing Corporation's regulatory supervision in October 2007, after which significant mismanagement and serious financial difficulties came to light, and in December 2007 the association petitioned the Court to wind up and their secured creditors appointed receivers. According to the inquiry report Ujima was the first registered social landlord to suffer this fate. Its assets and liabilities were transferred to London and Quadrant and for the two years ended 31 March 2008, losses attributable to Ujima totalled £28m, which included a write-down of £12.5m on four Ujima development projects. The inquiry raised concerns over the regulator's willingness to intervene timeously and effectively. It also revealed the limitations in combining the government's affordable housing investment and regulatory side under one roof: the investment side of the Housing Corporation was apparently focused on delivery, with insufficient consideration of the governance implications of a failing development programme. The other key finding was around Ujima's governance. The board had been weakened by the loss of three key members in one year, and 'the remaining board members provided insufficient challenge to management and did not insist on the

³¹ Some organisations have more than one reason for engagement, so the total is more than 48 organisations

provision of proper information sufficient to fulfil their responsibilities'.³² So what are the lessons for Scotland? The SHR probably has the right tools to intervene quickly, and the separation of the regulatory and investment divisions has already occurred. However, evidence from the current regulation plans could suggest that self-regulation and strong governance still has some way to go in Scotland's housing association sector. This may mean the SHR will continue to have a more hands-on role than perhaps Crerar intended, but perhaps this is a price worth paying in the short term until the culture of independence is fully embraced.

Government: a clearer landscape?

Are tables turning?

Apart from the absorption of housing investment and strategic functions into the Scottish Government and the creation of the SHR, the main change in the government landscape this year has been the new relationship between the Scottish Government and local government. The publication of the Spending Review in 2007 was accompanied by the Concordat, which aims to enhance the role that local government plays. The Scottish Government will still set the policy direction and national outcomes required, but 'will stand back from micro-managing service delivery, thus reducing bureaucracy and freeing up local authorities and their partners to meet the varying local needs and circumstances across Scotland'.³³ In practice for the housing sector, this means considerable change not only between local and central government, but also local government, housing association and Scottish Government. Coupled with the change in SHR, and Communities Scotland investment role transferring to Scottish Government, the last year has and will continue to require a considerable amount of adjustment in relationships, from all quarters.

By all accounts³⁴ tables do appear to be turning, although it is not as simple as relationships changing at local government versus Scottish Government: there are also subtle but important differences between Scottish Government central and local (ie, ex-Communities Scotland area office staff). Where previously local area office staff may have informed local authority housing strategists of the latest emerging policy, practice or income streams, now many of the 'hotlines' are between local authority and central government staff – and then the area offices and housing associations may find out later once the 'deal is done'. Understandably many housing associations are now working even harder on developing their own direct routes of communication to local authority colleagues and cutting out the middlemen and women. In terms of homelessness, relationships also appear to be softening – some suggest the Scottish Government is giving some flexibility on the 2009 interim target 'due' date, and that it is showing some toleration of duties being discharged through the private sector where the homeless applicant is agreeable to this solution.

The Concordat emphasises the overall theme of efficiency: a new performance monitoring framework to replace the 'myriad' of existing systems; implementation of Crerar

³² http://www.housingcorp.gov.uk/upload/pdf/Ujima_report_FINAL.pdf

³³ <http://www.scotland.gov.uk/Resource/Doc/923/0054147.pdf>

³⁴ According to consultees' feedback sought for this review

recommendations for self-assessment and proportionate regulation in local government; reduction in the number of funding streams; and local government to retain their efficiency savings for re-deployment. There have been mixed responses from the housing sector, and concern over the implications of removal of ring fencing in some areas – in particular for Supporting People and homelessness – and the rolling up of Community Care and Children and Families budgets and Mental Illness Specific Grant into the overall local government settlement.³⁵ Consultation undertaken for this review has revealed commonly held perceptions over cuts in Supporting People and care services, and their drive to make efficiencies by ‘absurd procurement/tendering policies and practices’ – this is probably not a direct result of the commitment in the Concordat agreement as the reduction in Supporting People funding has been high on the agenda for a number of years now. However, it will be interesting to see how efficiency savings will be delivered and what outcomes will be achieved as a result.

³⁵ Its All Settled, A New Relationship between the Scottish Government and Local Government, July 2008

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