

Selling off the stock



An interim analysis of the proposals for sales of council houses in high-value areas to finance a new right to buy for housing association tenants October 2015

This interim analysis takes into account several national studies which have examined aspects of the two inter-linked policies, high-value-area sales (of local authority stock) and right to buy for housing association (HA) stock. It is intended as an assessment of the overall impact of the policies. In the absence of published policy statements on key aspects of the policies we have made informed assumptions (in the case of high-value-area sales, based on the April 2015 Conservative Party manifesto announcement).

The analysis was carried out for the Chartered Institute of Housing by John Perry, Steve Wilcox and Peter Williams supported by the four housing trusts which make up the Pegasus Group of housing associations – Affinity Sutton, Guinness, Peabody and Southern.

Overall findings

Our overall conclusion is both policies are likely to produce levels of sales some way below the original expectations. At the same time, funds raised by high-value area sales will not fully cover the cost of local authority (LA) replacements *and* the cost of discounts under an extended right to buy.

High-value-area sales (HVAS)

- HVAS property turnover will be around half what is expected - 3.5% per annum (Conservative Party manifesto figure = 7%).
- Total sales of between 2,100 up to 6,800 homes per annum will be generated (manifesto figure = 15,000).
- We estimate HVAS receipts will be between £1.2 and £2.2 billion per annum depending on assumptions made, whereas the Conservative Party assumed £4.5 billion.
- The lower figure will only amount to half the amount needed to pay for HA discounts, while on our higher estimate virtually all the receipts would be required, leaving very little for LA stock replacement or for the 'Brownfield Regeneration Fund'.
- If the powers in the Housing Bill are used to require LAs to make payments on assumed levels of sales that are not in practice achievable and are therefore not backed by actual receipts, then the required payments will inevitably further affect authorities' ability to invest in their stock and in new build.

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High-value-area replacement housing

- On LA stock replacements, we assume that they will be much cheaper than the properties sold, that 'the same area' will be defined loosely and that there will be virtually no replacements in central London; all replacements will be at Affordable Rents. (While this is not our preferred or recommended option it is a generous assumption that creates the maximum potential for building new homes.)
- If LA stock replacement is to be fully funded it will require adjustments to the caps on LA borrowing, as some councils will otherwise not have sufficient capacity.
- Under the 2012 plans to 'reinvigorate' right to buy, LA replacement costs were assumed to be £42,000 from each receipt. Taking account of increases in land and property prices we assume a slightly higher contribution of £48,000 is required.
- Therefore prioritising LA stock replacement would leave insufficient funds (from £1.1 to £1.7 million) to meet the costs of compensating HAs for right to buy sales (see below).

Right to buy (RTB2) sales and replacements

- HA tenants entitled to RTB2 will number about 1,450,000. About 1,070,000 will initially be eligible by length of tenancy with a further 125,000 or so becoming eligible annually.
- We estimate that 10% of those eligible will buy over the first five years. Taking those currently eligible plus those becoming eligible each year, this would suggest some 145,000 sales over that period, with most sales occurring in years 2 and 3.
- The average value of dwellings under the current right to buy (RTB1) in 2013/14 was just under £126,000, with average discounts close to 50%. Making a modest allowance for house price increases and assuming an average 50% discount, 145,000 sales would have a value of some £20 billion, split evenly between achieved receipts of £10 billion and discounts of £10 billion, i.e. £2 billion per annum.

Provisional conclusions on the linked impact of HVAS and RTB2

- If there was a fully effective replacement programme this would result (after a time lag) in an annual average of some 31,100-35,800 new LA and HA dwellings over five years.
- However in practice we anticipate that the levels of HVAS and RTB2 sales and receipts are only likely to support a programme of some 24,600-33,700 new LA and HA dwellings a year (with no funding then available for the brownfield site programme).
- Both policies further reduce the pool of homes available at social rents.
- Together with other changes such as the reductions in social rent levels over four years, there will be an impact on business plans and capacity in both parts of the social sector.
- If, as appears likely, receipts from HVAS are not sufficient to fully compensate HAs for RTB2 discounts, or if there is a time lag, there will be a cost to the government.
- On the other hand, if the cost is extracted from local authority Housing Revenue Accounts regardless of whether sales targets are achieved, there will be a further and potentially very damaging effect on councils' capacity to invest.
- It is vital there is detailed consultation on the two schemes and how they interact. This analysis shows that there could be very different consequences depending on the decisions taken. As well as considering the overall impact, the consultation needs to take into account the consequences for individual landlords and local areas.

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Background

The new right to buy is linked in policy terms to high-value-area council house sales because it is the proceeds from the latter that will compensate housing associations for the discounts they will be required to offer to tenants. At the moment, there is still considerable uncertainty about how the two policies will operate and interact, including whether HVAS will deliver receipts of sufficient value, quickly enough and distributed in the right way to compensate HAs. In both cases the government has promised that there will be one-for-one replacement of units sold, which raises inevitable questions about whether this is feasible, over what timescales and whether sites can be found in the same areas. It has also promised to invest a portion of the money raised in a 'Brownfield Regeneration Fund' of £1 billion over five years.

This analysis aims to make a balanced assessment of the impacts of these linked policy changes. It is a preliminary assessment based on the limited information so far available. The Summer Budget announced further important changes that affect any full analysis. These include the cuts in social sector rents of 1% each year until 2020, new pay-to-stay rules applying to higher-income social tenants, and several changes in welfare benefits that will potentially affect landlords' incomes. At this stage, however, it is not possible to integrate their effects into our assessment of RTB2 or HVAS.

We also note that the new proposals bring new contradictions:

- rents will be reduced overall but conversion of individual properties to Affordable Rents will still be encouraged and newly built homes will also be at these higher rents
- higher-paid tenants no longer subsidised via sub-market rents will be eligible for a substantial subsidy (via the discount) if they opt for right to buy
- the effects of HVAS are likely to be concentrated in London; achieving replacement in London will be much more difficult but at the same 'exporting' London receipts to other areas will be controversial.

This summary analysis is in four sections. The first considers the high-value-area sales (HVAS) scheme, the second the right to buy (RTB2), the third the replacement of properties sold and the fourth brings these together in our conclusion on the feasibility of the combined policies.

1. High-value-area sales of local authority stock

How many will be sold?

The Conservative Party election manifesto said that 'local authority properties that rank among the most expensive third of all properties of that type in their area - including private housing - will be sold off'. A press release on 14th April defined high-value-area homes by size and regional thresholds (see Figure 1).

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Figure 1: Conservative Party estimates of value thresholds for high-value-area sales

| | 1 bedroom | 2 bedroom | 3 bedroom | 4 bedrooms | 5 or more bedrooms |
|--------------------------|-----------|-----------|-----------|------------|--------------------|
| North East | 80,000 | 125,000 | 155,000 | 250,000 | 310,000 |
| North West | 90,000 | 130,000 | 160,000 | 270,000 | 430,000 |
| Yorkshire and the Humber | 85,000 | 130,000 | 165,000 | 265,000 | 375,000 |
| East Midlands | 105,000 | 145,000 | 175,000 | 320,000 | 430,000 |
| West Midlands | 100,000 | 145,000 | 180,000 | 305,000 | 415,000 |
| East | 155,000 | 220,000 | 265,000 | 440,000 | 635,000 |
| London | 340,000 | 400,000 | 490,000 | 790,000 | 1,205,000 |
| South East | 165,000 | 250,000 | 320,000 | 495,000 | 755,000 |
| South West | 135,000 | 200,000 | 260,000 | 375,000 | 535,000 |

Source: Conservative Party press release 14 April 2015

The manifesto pledge was understood to be based on a 2012 paper by the Policy Exchange (PE), *Ending Expensive Social Tenancies*, which included all social housing, whereas the current proposal is restricted to council housing. It included properties valued above the regional median house price adjusted for bedroom size, suggesting that 339,000 properties would potentially be sold. At a turnover rate calculated by PE to be 3.5% annually, sales under their scheme would total 11,800 per year.

PE has re-done its estimates on the basis of sales covering the top third of market values, as now proposed. It concludes that the scheme will now apply to 210,000 LA properties (11.6% of the stock).¹ But this is based on out-of-date stock data; updating it to March 2014 gives a figure of 194,000 properties. PE's estimated turnover rate would produce 6,790 sales per year. However, the government is assuming there will be 15,000 sales annually, which PE believes is 'challenging'.

The average turnover rate for all LA lettings over the last seven years is 6.7%,² but this *includes* internal transfers and transfers between social landlords. Assuming these are allowed to continue in order to facilitate tenant mobility, the underlying turnover rate falls to just 4.2%. In addition, it seems reasonable to assume that the top third in value of LA stock will typically be more popular and have lower turnover.

There is evidence to support lower turnover rates from two other sources:

- A Local Government Chronicle survey of local authorities, based on the regional high value area thresholds in Figure 1, suggests turnover in the range 3-4%.³
- An interim study carried out in four London boroughs (called here the 'four boroughs study') shows turnover rates in the range 3.1 - 4.4%.⁴

¹ See www.policyexchange.org.uk/media-centre/blogs/category/item/the-government-s-right-to-buy-targets-are-achievable-if-the-politics-are-possible

² See *Social housing lettings in England, 2013/14: Continuous Recording (CORE) data*.

³ Calkin, S. (2015) 'LGC research reveals the winners and losers in council homes sell-off plan' in *Local Government Chronicle*, 10 June.

⁴ Liverpool Economics (2015) *Potential effects of the sale of higher-value council homes – Interim report* (see http://www.lgcplus.com/Journals/2015/05/28/v/a/g/HigherValueCouncilHomeSales_InterimReport_Version_04.pdf).

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Savills has also explored the issue in some detail.⁵ They indicate that 10% of LA housing in England is above the 70th percentile value for all housing – or 167,000 homes based on 2014 stock data – varying from none in the East Midlands to 14% of stock in London. Then using the 2014 distribution of market transaction values for areas, adjusted on a regional basis for the difference between the market value of social housing and all housing, they argue that the total number of homes over the thresholds would be just 59,000 based on 2014 stock data. At a 3.5% turnover rate this would imply just 2,070 sales a year.

Shelter's report *The Forced Council Home Sell-Off* has more detail on the local impacts but given limited detail on its methodology is difficult to compare with PE and Savills.⁶ Overall, it assesses the likely total of HVAS properties to be 113,000 with annual sales running at 3,875. It suggests that 60% of the sales would occur in just 20 authorities and confirms the reliance on London for sales revenues from the scheme.

All the evidence is therefore that the choice of the area basis for the HVAS scheme is very important and any definition will create anomalies. For example, on a regional basis, an LA like Epping Forest (in the East) would be penalised heavily because it adjoins London, whereas neighbouring Enfield would have no properties below the London threshold. At the other extreme, if each LA area itself were taken as the basis for HVAS thresholds, many would have no sales at all as they would have no stock in the highest third of values locally.

As this discussion suggests, until there is some clarity as to the 'rules' we are forced to make assumptions as to how HVAS will work. Based on the PE and Savills analyses, adjusted to reflect March 2014 stock and turnover data, we make the following assumptions:

- turnover will be 3.5% per annum (manifesto figure = 7%)
- total sales of 2,100 up to 6,800 homes p.a. will be generated (manifesto figure = 15,000).

What receipts will the scheme generate?

The government estimates that the 15,000 sales will generate £4.5 billion in usable receipts, after certain costs are paid, an average net receipt of £300,000 per property. Allowing for costs associated with the sales (see below), this would assume an average gross receipt or market value of some £322,000 per unit. Is this reasonable?

If correct, Figure 1 shows that while an £322,000 average value is exceeded by all sizes of property in London, outside London it is only met by 3-bed properties in the South East and the small numbers of 4- or 5-bed properties in some other regions. Therefore only if HVAS sales are heavily weighted towards London will the average gross receipt reach £322,000. However, the Savills note suggests HVAS sales are likely to be *even more* concentrated in London, and that as a result the average receipt could be more like £580,000 per unit. While in the four boroughs study the average value generated was lower, at £400,000, the study did not cover the areas of London with the most expensive local authority properties.

⁵ Buckle, C. (2015) *(Social) Home Truths* (see www.savills.co.uk/research_articles/186866/189182-0).

⁶ available at http://england.shelter.org.uk/professional_resources/policy_and_research/policy_library.

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In order to make an estimate of the likely yield from the HVAS policy we have to settle on figures for the average value of properties as well as for the numbers sold. Our lower figure for sales is derived from the Savills analysis, with sales concentrated in London. Applying their average valuation (£580,000) to the lower estimate of sales (2,100) suggests a gross annual receipt of about £1.2 billion – little more than a quarter of the figure assumed by government. The higher sales figure of 6,800 is based on PE's analysis and assumes a higher proportion of sales outside London, with much lower average receipts. Using the government's own average sales figure (adjusted upwards to £322,000 – as explained below) this would generate some £2.2 billion annually, still less than half what the government hopes to raise.

These analyses are based on the limited information currently available about how the HVAS might operate. If, for example, thresholds were to be set at different levels, or structured locally rather than regionally, this would result in a very different profile of sales and receipts.

How will receipts be apportioned for different purposes?

On the basis of these different assumptions there will be from £1.2 to £2.2 billion sales receipts to distribute on an annual basis. The question then is how those funds might be distributed across the different priorities identified by government. Under the current LA right to buy (RTB1), the priority claims on the receipts are (in this order):

1. An admin allowance deductible from the receipt.
2. Repayment of attributable debt on each home sold.
3. Certain amounts payable to the LA and to the Treasury.
4. Any remaining receipt being applied towards funding of replacement homes.

For the purposes of this study we have assumed:

- only steps 1 and 2 above will be prior claims on the receipts and step 3 above (compensation payments to the LA/Treasury) will not apply
- one-for-one replacement of LA homes sold will be a first call before the balance of sales receipts are made available for the remaining claims.

On this basis the priority order of calls on HVAS receipts is assumed to be:

1. Pay LA admin costs – we have applied a rounded average figure of £2,000.
2. Repay attributable debt on each home sold – we use a round figure of £20,000 – only a little more than the average debt figure of £15,860 per unit in March 2014.
3. One-for-one replacement of each LA house sold under HVAS.
4. Recompense HAs for the cost of discounts under RTB2.
5. One-for-one replacement of each HA house sold under RTB2.
6. Finance the £1 billion 'Brownfield Regeneration Fund'.

The first two claims deduct on average £22,000 from each receipt. At this stage, while it is not clear that item 3 (one-for-one replacement of LA stock) will take precedence over items 4-6, we have assumed it will be deducted before the remainder is pooled for the remaining items. Our assessment of the costs for items 3-6 is given in the sections below.



Conclusion: what receipts will be available from high value area sales?

Our working assumption for the next stage of the assessment is that between 2,100 and 6,800 sales will take place annually under HVAS, generating an average receipt of £580,000 for the lower sales figure and £322,000 for the higher one.

After deducting £22,000 costs per unit for admin and debt, this will produce net receipts in the range £1.2 to £2 billion annually. If units sold under HVAS are fully replaced (at a cost of £100-300 million annually – see below), we estimate that HVAS would generate some £1.1 to £1.7 billion annually for the other programmes (or £5.4 to £8.6 billion over five years).

Both the Savills and Shelter reports suggest that receipts will be concentrated in London, raising inevitable issues about the likely need to ‘export’ London receipts to compensate for RTB2 discounts elsewhere in the country.

2. Extending right to buy to housing associations

How many HA tenants are likely to qualify for and exercise RTB2?

In total, RTB2 will apply to just over 1.45m new households. But some 26% of social tenants have been tenants for less than three years.⁷ The numbers eligible for RTB2 by virtue of their length of tenancy will initially therefore be about 1,070,000, with a further 125,000 or so becoming eligible annually. This is rather higher than the NHF’s initial estimate of 850,000.⁸

How many of these will be willing and able to buy? About 25% of social housing tenants expect to buy a home at some time; of these only 42% expect to buy their current home, so roughly 10% of all social tenants expected to buy their current home *at some time*.⁹ Can the aspiration to own be translated into getting and sustaining a mortgage and/or raising sufficient cash? There are now fewer higher-income tenants in housing association lettings and mortgage market rules are much tighter. Our assumption is therefore that fewer will be able to access mortgages than was the case with RTB1.

After RTB1 was introduced in 1980 just 10% of council tenants took it up within five years. Current constraints suggest a rather lower level of take-up of RTB2, but there will also be an extra ‘push factor’ on higher-income tenants as a result of the planned ‘pay-to-stay’ scheme. Taking these factors into account, we take the 10% level of RTB1 purchases over five years as a balanced mid-range estimate for RTB2 over the same period. This suggests some 145,000 sales, with most occurring in years two and three, somewhat lower than the original NHF estimate (220,000 sales over five years) but above that of the LGA (120,000).¹⁰

⁷ DCLG (2015) *English Housing Survey Headline Report 2013-14*. DCLG.

⁸ See www.housing.org.uk/media/blog/right-to-buy-extension-estimated-to-cost-12-billion/

⁹ DCLG (2015) *op.cit.*

¹⁰ LGA (2015) *Extending right to buy to housing association tenants will cost £6bn*. Press release, 5 October.

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How much will be raised by RTB2 sales and what will be the cost of discounts?

The average value of sales under RTB1 in 2013/14 was just under £126,000, with average discounts close to 50%. Allowing for house price increases over five years, and with an average 50% discount, 145,000 sales would produce some £20 billion, split evenly between receipts of £10 billion and discounts of £10 billion (the LGA estimate of discounts is lower, giving a cost of £7.5 billion over five years).

Conclusion: how many sales will take place under RTB2 and what will they be worth?

Our conclusion is that some 145,000 HA tenants will exercise the right to buy in the first five years, at an average value of £138,000, with this being split equally between the receipt and the discount. The expected sales over five years would therefore generate around £10 billion of receipts (given that £10 billion would be accounted for by discounts).

3. Replacing the stock sold under RTB2 and HVAS

The manifesto promised that under RTB2 'homes sold to tenants will be replaced on a one for one basis' and that HVAS sales will be 'replaced in the same area with normal affordable housing'. There are of course issues about what these promises mean. Our assumption is central London will see very little replacement of sold homes in the same area. Elsewhere, we assume replacements will be in the same LA area but this is not critical for our calculations.

Local authority replacements

Under the 'reinvigorated' RTB1 in 2012 the government suggested a typical cost of a replacement LA unit of £140,000, requiring a contribution from the receipt of £42,000, with the remainder financed by borrowing. Taking account of price increases since 2012 we assume a slightly higher contribution of £48,000 per unit (we also assume that government's policy intention is that these homes will be let at Affordable Rent). This is in the mid-range of estimates. The IFS appraisal of RTB2 assumed £20,000 per unit based on prevailing grant rates;¹¹ however, this does seem potentially very low given the extra volume of building required. The four boroughs study assumes a higher grant (in London) of £64,000.

Our mid-point figure also bears in mind that councils' capacity will be affected not just by HVAS but by government policy to cut social sector rents over the next four years. District councils suggest this could remove over 40,000 new build units from their business plans.¹² Building replacements will, in many cases, also be possible only if borrowing caps are raised.

Housing association replacements

In the Affordable Homes Programme 2011-15, the average cost of new build was £145k per unit (ranging from £103k in the North East to £200k in London). Average grant was £18,800, varying from £14k in the East/South East to £25k in London. In the new AHP that began in April, the average grant so far is higher, at £23.5k. However it should be noted that these low

¹¹ Chandler, D. and Disney, R. (2015) *Extending the right to buy: Risks and uncertainties*. London: IFS.

¹² District Councils Network (2015) *Housing rent reduction policy will hit plans to build 42,000 new homes*. Press release, 27 July.

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AHP grant levels are based not just on the new dwellings being let at Affordable Rents, but on cross-subsidy from relets of existing HA stock being switched from social to Affordable Rents. Moreover the capacity to undertake one-for-one replacements will be constrained by the reductions in existing social sector rents and the impact of the next wave of welfare reforms.

Nevertheless, if the cost of deposits were fully repaid, associations could (we judge) build 145,000 new dwellings over five years, i.e. replace those sold. Using all of our estimated net finances from HVAS sales (£1.1 to £1.7 billion annually) as compensation for RTB2 discounts might allow some 112-134,500 new dwellings to be built, i.e. fewer than the numbers sold. While outside the scope of this work, we also note expert views about the limited ability of the construction sector to grow quickly over a sustained period of time and so actually finding the extra capacity to deliver this additional number of homes could be a critical constraint.

4. Interim conclusion – bringing the figures together

Do the finances work?

Looking initially at the HVAS scheme, given that higher-value properties are being sold, and replacements are let at higher rents, then as long as the receipt is sufficient to pay the admin and debt costs, and to fund the replacement unit, in narrow terms the scheme will work. The main drawbacks will of course be:

- higher levels of debt within the HRA requiring raising of borrowing caps where needed
- replacement units being less affordable than those sold.
- a time lag and (in some areas) extreme difficulty in replacing units sold in the same area.

The key issue however is whether the HVAS will not only achieve the above but provide enough funds for RTB2 (and, in theory, the Brownfield Regeneration Fund). While we have taken a more cautious view of the volume of both HVAS and RTB2 sales than the projections when the scheme was announced, we still expect the discounts associated with RTB2 sales to require funding of around £2 billion per year. On our lower estimate of HVAS receipts this level of funding could not be met; at our higher estimate it could be achieved only at the cost of not building the replacement LA units and not contributing to brownfield regeneration. The Shelter report concurs with this assessment.

There are also time lags involved, given that HVAS will take time to set up. If RTB2 were to be started at the same time, there would be delays in funds coming through to compensate HAs for the discounts given on sales. There is therefore potentially a double problem of receipts being insufficient and time lags before they start to flow through. This suggests that a 'gap funding' arrangement will need to be considered for RTB2, with a cost to government that may be short-term or may be permanent depending on HVAS receipts.

What would be needed to bring receipts and costs closer together?

The first critical area is the volume of HVAS sales. Our estimates inevitably include a degree of speculation given that nothing resembling this policy has been implemented before. While receipts could be increased by widening the criteria, there would be considerable downsides

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especially in the effects on lettings. Beyond the point where sales ceased to be 'high value' there would in any case be diminishing returns in terms of value per unit, ease of selling and adverse publicity; and of course replacement costs would remain the same.

Another approach to closing the gap would be to tackle the cost of RTB2 by tempering demand for it. For example, smaller discounts would both suppress demand and reduce the amount needed to compensate HAs. Alternatively, the qualifying period could be increased from three to five years, which would still mean that long-standing tenants were eligible. Without such changes, it is difficult to see how the gap could be closed. Hence our overall conclusion is that full consultations are required on the details of the two schemes, how they will interact and their implications for housing supply more generally, before either scheme is implemented.

What happens if the government imposes the costs of RTB2 discounts on local authorities, even if HVAS receipts are insufficient to pay for them?

The Housing Bill makes provision (section 62) for the Secretary of State to require local authorities to make an annual payment to government based on the market value of the authority's interest in any high value housing that is likely to become vacant during the year. In other words, the payments may be unrelated to actual sales, with the risk that either across the board or for individual authorities a value is set which is not achieved by the sales which actually take place. While of course the details of how this might work are not yet available, if these powers were to be used to require LAs to make payments on levels of sales that are not in practice backed by actual receipts, then those payments would inevitably further constrain authorities' ability to invest in their stock, both in maintaining the existing stock and in constructing new housing.

While this would be a further way to 'close the gap' between the costs of RTB2 and receipts from HVAS, and potentially avoid the excess cost falling on government, it could (depending on the amounts involved) represent a serious blow to councils' capacity to invest and to the integrity of the 'self-financing' agreement with councils which government entered into in April 2012.