

# Accommodating contestability in social housing

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Housing is a significant element in government spending, with some \$2b of assistance being provided through income-related rents and the Accommodation Supplement in 2010 alone. Despite having \$15b of assets, HNZC sought around \$85m of new funding for new builds and upgrades, suggesting the portfolio cannot generate sufficient return (in this case 0.5%) to be self sustaining.

### 2010 Forecast (\$m)

|                          |        |
|--------------------------|--------|
| Land and building value  | 15,100 |
| Accommodation supplement | 1,158  |
| Income related rents     | 528    |
| Capital expenditure      | 388    |
| Housing innovation fund  | 20     |

Source New Zealand Treasury: Budget Economic and Fiscal Update 2010, and New Zealand Treasury: The Estimates of Appropriations 2010/11 both available at [www.treasury.govt.nz](http://www.treasury.govt.nz)

The 2010 Housing Shareholders' Advisory Group report<sup>1</sup> (HSAG Report) on social housing in New Zealand concludes that the current model of social housing delivery will struggle to meet future needs. The full cost of ensuring New Zealand's state housing is fit for purpose and meets demands is estimated to be "in the billions". With government finances under strain, Crown departments and entities are being asked to reappraise what they are doing and how they are delivering services. For a priority public service such as housing, finding better and smarter ways to deliver improved services for less is critical. This KPMG paper looks in detail at some of the steps taken in the UK to encourage greater partnership between the public, private and not-for-profit sectors. These steps have increased competition in the provision of social housing which has led to an improvement in housing condition, tenant services and better value for money.

New Zealand is coming off the back of a period of soaring house prices and a declining rate of home ownership. The demand for state housing in its current form has never been stronger, which sits uncomfortably alongside a legacy of old state homes in need of maintenance, repair and refurbishment. There is demand for both new homes and significant investment to upgrade or modify existing dilapidated housing.

State housing is the second largest Crown asset in New Zealand with approximately 66,000 state homes (excluding leased houses) with land and buildings valued at around \$15 billion. There are some specific challenges facing the sector, most notably:

- The current HNZC property portfolio has a large number of properties of the wrong type, in the wrong location. There is oversupply of 3 bedroom dwellings (when demand is for 1-2 and 4-6) and a geographic distribution reflecting historic investment rather than the current demand.
- There has been a significant deferral of upgrades and refurbishment over recent years, reflecting a heavy focus on acquisition. The cost of upgrading the current housing portfolio to a decent standard is estimated at \$2 billion<sup>2</sup>.
- The Government is seeking a better overall return on its substantial investment in state housing. New Zealand's social housing delivery model is dominated by HNZC<sup>3</sup>. The HSAG Report identifies wider collaboration with private and third sector (not-for-profit and Iwi providers) as a key recommendation to achieve both an improvement in the quality and diversity of housing stock and to introduce new funding into the sector and leverage the substantial Crown asset value.

It is widely accepted<sup>4-5</sup> that high quality social housing can lead to wider community benefits, with an improvement in socio-economic indicators. It can lead to a better reputation for stigmatised neighbourhoods and lower crime rates, while providing greater opportunities for members of the community – for education, for work, and for greater self esteem. This principle underlies the Tamaki Transformation Programme in South Auckland, which “*strives to achieve ambitious housing, social services and economic performance goals for the area*”<sup>6</sup> through partnerships between central government agencies, local government and the private sector.

## What can we learn from the UK experience?

Parallels can be drawn between the current position in New Zealand and recent experiences in the UK. The UK government has taken a variety of steps over the past decade to increase private and third sector participation in the delivery of social housing to overcome similar hurdles. The UK experience provides some useful lessons which may help inform whether comparable steps can be taken in New Zealand to increase contestability in social housing provision.

For many years the UK faced major problems in providing sufficient decent accommodation for those who are unable to afford housing on the open market. In some areas there has simply been insufficient housing available to meet the demand for accommodation. In others, there has been historic under-investment in existing social housing leading to a serious deterioration in the physical condition of the accommodation. These circumstances have been exacerbated over time by policies enabling sales of social housing to existing occupiers at a discount without such housing being replaced by the state.

The UK Government has sought to address these issues through a variety of structures involving the private and third sectors rather than by simply allowing more public money to be invested directly. The major

components of this approach have been:

- The establishment of ‘third sector’ providers – commonly called Housing Associations – and a set of funding arrangements that facilitate construction of new affordable housing stock
- Stock transfers from the Crown to Housing Associations, and
- Public Private Partnerships.

## The UK model

In the UK, funding for social housing is provided through a combination of housing subsidy provided to tenants and grants made available to providers of social housing. Tenants are obliged to pay rent which is less than an open market rent, set at a level designed to be affordable to those in low paid employment. For those who are not employed, the Government meets the rent liability, in whole or in part, through a means-assessed subsidy.

The gap between the cost of delivering the new housing and associated services and the amounts the tenants are paying is bridged by Government through a capital grant to providers of social housing which meets part of the capital cost of the housing. Other models from overseas also demonstrate a need for some funding directly to providers. In the US for example, this funding comes in the form of significant tax breaks for providers of social housing which contributes to their financial viability. Within New Zealand, the current situation leaves private or third sector providers on an unequal footing with HNZA, with the funding received from Government through the Accommodation Supplement made available to private or third sector landlords generally being less than HNZA would receive for the same property under the Income Related Rent Scheme. This misalignment leads to an anti-competitive position.

### UK Providers

Since 1988 a large number of not-for-profit organisations (whose ‘charitable’ objective is to deliver affordable housing to those in need) have delivered new affordable housing rather than the Crown. These organisations do not distribute profits to

shareholders but instead reinvest any profits made in delivering against their corporate objectives. These bodies are subject to a system of registration and regulation by a Government agency. The private bodies are known as Registered Providers of Social Housing or more commonly referred to as Housing Associations. This approach has been very successful and the not-for-profit sector has developed rapidly. Housing Associations are eligible for capital grants from Government to meet part of their costs of providing new affordable housing. The grant does not meet all of the construction cost of any particular project and the remainder must be met through finance raised privately. The ongoing operating and maintenance costs and the servicing of the private debt are financed from the rental income received.

This successful grant regime has recently been extended to the commercial developer sector. Under these arrangements, a commercial developer will be entitled to claim subsidy towards the costs of the construction of affordable housing that it subsequently transfers on to a Housing Association.

### Stock Transfers

The UK’s third housing sector was created mainly through large scale transfer of housing stock from Government control to newly created Housing Associations. This transformed the provision of social housing across the UK. Research published by the Joseph Rowntree Foundation<sup>7</sup> suggests “*such transfers aimed to address dilapidated property condition, halt neighbourhood decline, and sometimes remedy a legacy of mediocre housing management.*”

Housing Associations are able to borrow against the value of housing stock and anticipated rental revenues. The proceeds of this debt raising can, in part, be used to pay a purchase price to Government. By the end of 2009, £14.2bn (c. \$30.5bn) of private funds had been invested in housing associations in the UK<sup>8</sup>. A 2002 report for the Office of the Deputy Prime Minister<sup>9</sup> showed that the funding terms achieved by most Housing Associations represented good value for money.

In addition, the Joseph Rowntree Foundation research suggests that post the transfer of stock to Housing Associations four key themes were apparent; *"a more customer focussed approach; a growing interest in neighbourhood management; a greater trend towards functional specialisation (e.g. designated rent arrears staff); and a 'more active' style of management."* The research also notes that average tenant satisfaction tended to improve after transfer, and that evictions rates were lower under Housing Associations formed by whole stock transfer (0.43%) when compared to traditional provision (0.70%).

Virtually all newly created Housing Associations were initially staffed largely by former council employees<sup>6</sup>. This helped to alleviate the problem of a general lack of expertise in managing housing stock on a large scale within the private or third sector in the short term – a problem which may also be encountered in New Zealand. However, despite the use of existing staff the research states *"from the viewpoint of transferring staff, the post transfer regime is widely seen as replacing a bureaucratic, hierarchical work environment with one which is more egalitarian, inclusive and encouraging of initiative."* There is significant evidence that opening up public sector housing services to contestability has encouraged innovation and ensured greater efficiency. The management boards of Housing Associations in the early days also included both Government and tenant representation.

### Public Private Partnerships

Over the last 10 years there has been an increasing use of Public Private Partnerships (PPPs - most commonly referred to as the Private Finance Initiative in the UK) to provide social housing. Under this model, the Government contracts with a private provider to design, build, finance, maintain and operate the social housing for a predetermined length, ordinarily 25 or 30 years. The Government pays the private sector for providing the dwellings, along with associated services through an annual payment.

**PPPs are argued to have some considerable benefits, some of which are detailed in the table below.**

|  |   |
|--|---|
| <b>Incentivised performance</b>        | As the payment received by the provider is dependent upon both good maintenance and strong operational performance, this incentivises good performance. The role of the funders to the providers should not be underestimated here – the fact that there are significant amounts of debt held by the private providers means that substantial due diligence is undertaken by funders prior to contract signature, and that extensive operational monitoring is undertaken by funders during the concession. |
| <b>Competition leads to efficiency</b> | The granting of a contract to a private provider is only done after an extensive competitive process. This competitive process drives out efficiency in the operational procedures.   |
| <b>Innovation</b>                      | This need for efficiency leads to innovation in the design and delivery methods used. This is especially encouraged where the Government specifies KPIs which measure success on the basis of outputs and not inputs, or in other words specify what they want to achieve, but give the private sector some freedom of how they want to achieve it.   |
| <b>Whole life costing</b>              | The fact that payment is based on the cost over the whole concession focuses the private provider on optimising the whole life cost of the asset, rather than just minimising construction costs.   |
| <b>Risk transfer</b>                   | PPPs transfers public sector risk to the private sector. Where this risk can be better managed by the private sector then it is likely to be able to price it better, which will lead to efficiency savings.  |

Payment commences once the properties are completed – no payment is made during construction, hence the private sector is required to obtain private finance to fund the development, which is then repaid over the contract life as income is earned. The Government's payment is linked to the availability of the dwellings and the performance of the operator. The availability payment is dependent upon the provider meeting strict availability criteria, which ensures the effective long term maintenance of the properties. Predetermined KPIs are agreed and targets set, with failure to meet these targets leading to a reduction in the amount of payment made by the Government. This acts as a powerful incentive to the private sector to ensure good performance. These KPIs are usually set to measure key project outcomes, such as the degree of tenant satisfaction and the incidences of anti-social behaviour.

PPPs have been used to provide both new build estates, and refurbish and operate existing stock. Whilst refurbishment properties provide an

extra risk to the private sector partner due to the difficulty in assessing the condition of existing stock at the date of handover, the UK market provides clear evidence that this does not act as a barrier to obtaining value for money.

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Due to these reasons PPPs are becoming an increasingly prevalent method of funding social housing in the UK. In 2009 the UK Government announced a further £1.7billion (approx. \$3.7bn NZD) of funding available to the latest round of social housing PPP deals<sup>10</sup>.

### Finding the right form of private sector participation for New Zealand

The Government already works with the private sector to provide state housing in New Zealand. Many tenants live in houses owned by the private sector but managed by the public sector. The question is whether there

are other arrangements that can offer better housing services for tenants, and better value for taxpayers. The evidence from the UK shows that there are various structures under which elements of the provision of social housing can be transferred to the private or third sectors. Whilst it's easy to talk about these as discrete options, such as stock transfers or PPPs, in reality there is a spectrum of services which can be transferred to provide better value for money. This is demonstrated diagrammatically below.

As we move from left to right the number of services and risks which are transferred from Government increases, with a general corresponding decrease in Government control.

The purpose of this article is not to discuss each of these options in detail, but to highlight that even under a PPP approach, there is still a wide variety of decisions to make as to which services and risks should be transferred. An in depth feasibility study and business case will be needed to analyse each of these decisions, including the constraints and capabilities of the private or third sectors to deliver the transferred services.

Any decision on increasing the role of the private sector should be driven first and last by long term value for money. Where the desired outcomes of a project can be defined and measured and where the risk of delivering those outcomes can be passed to and better managed by the private sector, then a form of PPP may offer this value for money. Where the private sector is

better placed to manage demand risk, transferring it may provide better value for money.

What has provided the best value in the UK may not be immediately transferrable to New Zealand. If an alternative provider approach is to be used here, the New Zealand Government should pick and choose carefully to encourage and nurture private and third sector development. The question remains as to whether a 'big bang' approach of wholesale stock transfer or a more controlled approach of slowly building market capacity and capability will best deliver transformational change and better services for less investment over the long term. Either way, the market will require appropriate signals of intent from Government before it will make significant investment.

### Mixed Tenure

The objectives of successful delivery of social housing are not only to provide improvements in social housing quality and quantity, but also to provide mixed communities and to address the wider regeneration of local communities. The provision of mixed tenure estates with social housing 'pepper potted' amongst homes for private sale is often seen as key to avoiding a socio-economic divide between owner-occupied homes, privately rented homes and social housing. It can encourage community cohesion.

A new estate being built in this way aligns well with private or third sector participation – it is not normally seen

as the government's role to provide housing for private sale. In order to achieve genuine tenure blindness, i.e. the inability to distinguish property tenure from the design or specification of the property, the same contractor must be used for each property, with contractual links between the different types of development. This presents an opportunity for partnership between the public and private sectors. Private sector innovation in the delivery of mixed tenure estates can add to the value for money of deals through the increased attractiveness of both social housing and owner-occupied dwellings to the market. This means greater value is obtained from the land provided for the scheme, therefore reducing overall cost, as well as increasing the customer focus of the houses provided and capturing socio-economic improvements.

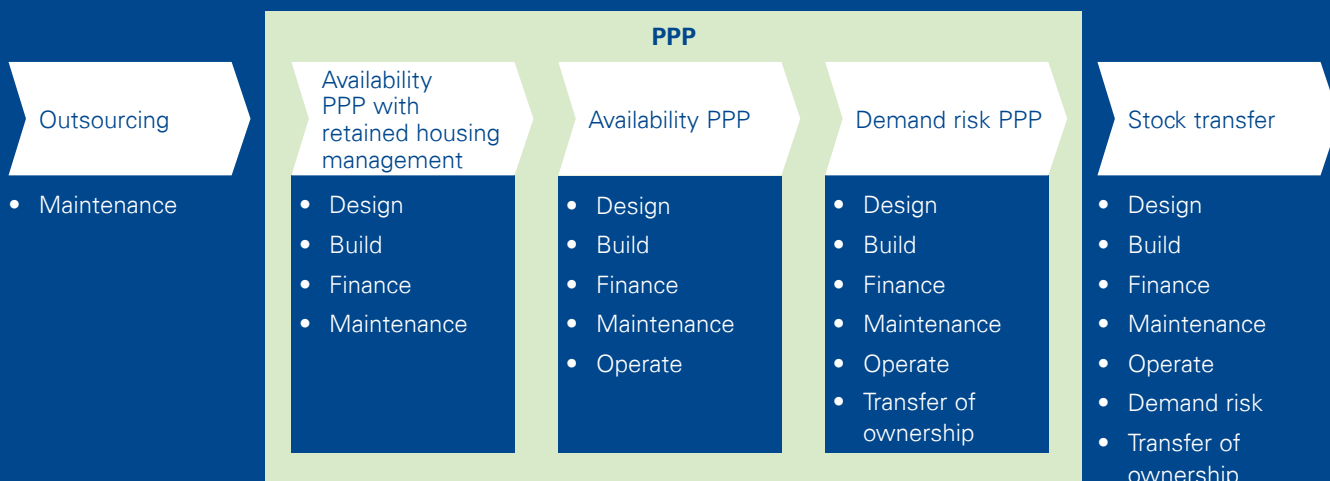
### Third party income/retail

The public sector is often not best placed to manage the possibilities of third party income within a housing development, which could include the provision of retail outlets and community facilities.

The private sector usually has greater expertise in the management of opportunities for third party revenue, through its design of estates, efficient operation and commercial focus. Innovation in this area can often lead to significant subsidies against the cost of social housing provision.

Risk transfer

Control



## Conclusion

The UK provides a useful framework for encouraging alternative provision of social housing. The creation of regulated not-for-profit organisations and the transfer of existing stock to them is a method which has proved successful. PPPs have provided a further evolution of this model to transfer risk to the private sector and to encourage efficiency and incentivise performance, while still allowing Government to retain control of price and quality. Both of these methods which have been successful in the UK share two common and related themes.

First, there is a need to provide some Government funding to make the deals financially viable for the private or third sectors, and to stimulate investment. Whilst funding being provided in the form of income related rent subsidies directly to tenants may provide the tenants with greater choice about their housing solutions, it may not provide the necessary stimulus to encourage new entrants to social housing provision. The UK models all provide some subsidy directly to suppliers, either through capital grants to Housing Associations or through availability payments to PPP partners. Where these subsidies are provided, they should leave all potential providers on a level playing field.

Secondly, if the Government wants real change in the efficiency and delivery of social housing then it must take proactive steps to encourage private or third sector investment. The alternative provider market is interested, but is looking for the right signals from government.

If the New Zealand Government gets this right then the international evidence suggests that this could lead to an improvement in housing stock, a more customer focused approach and an improvement in tenant satisfaction, all while retaining Government control of price and quality and providing better value for money.

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