

# The developing new approach to investment: An evaluation

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This evaluation was carried out and written by Campbell Tickell.

## **Background**

The Housing Corporation is responsible for investing grant in affordable housing, and protecting that investment through regulation and contract. Under new powers in the Housing Act 2004, the Corporation became able to make grants available to unregistered bodies, as well as to Registered Social Landlords (RSLs).

In order to develop and test a new approach to the competitive process, a pilot programme of £200 million was established: New Partnerships in Affordable Housing (NPiAH). This programme and the National Affordable Housing Programme (NAHP) 2006-08 were opened up to both RSLs and non-RSLs for the first time.

The Corporation commissioned Campbell Tickell to evaluate the new arrangements through NPiAH and NAHP. The core purpose of the evaluation was to examine:

- what had worked effectively in terms of the new arrangements for making grant available to non-RSLs;
- what needed improvement; and
- how those improvements could be made in the future.

The methodology involved the following:

- review of documents;
- review of bids;
- questionnaire survey;
- focus groups; and
- one-to-one interviews.

## Key findings and conclusions

Prior to the NPiaH, the Corporation had no experience as an organisation of working with the private sector as a direct partner, in terms of evaluating and funding bids for development funding. A steep learning curve was required.

Despite this, within a short period of time and from a standing start, the Corporation has to date achieved the following, across the two programmes:

- over 150 expressions of interest from unregistered bodies;
- 16 unregistered bodies invited to submit detailed bids;
- bids from unregistered bodies totalling £339 million to produce 9,288 new homes; and
- allocations to nine non-RSLs worth £91.15 million, which are programmed to produce 3,048 new homes.

This represents a considerable achievement by the Corporation. It has made significant changes to its development grant systems, and has brought in a new group of players that operate on a quite different basis from those it has dealt with in the past. Inevitably, there are a number of areas in which, especially with the benefit of hindsight, one can identify the need for significant change. Overall however, the foundations have been laid to develop this process in the future and to engage with a greater number of new partners.

New systems were developed within tight policy constraints. These were based on a thorough and rigorous approach, but consultation and the evaluation of options were limited as a result of these constraints.

The systems were implemented through processes of qualification and detailed bidding. Bids were received and appraised, and allocations made. The response rate amongst non-RSLs was limited. Major factors influencing the number of bids appear to have been the complexity of the qualification/bidding process, the information requirements for bidding and what were seen as onerous conditions associated with the payment of grant.

The decision to open the whole of the national programme for 2006-08 to non-RSLs meant that there was no opportunity to run the two systems (i.e. grant to RSLs and non-RSLs alike, and the traditional approach limited to RSLs alone) in parallel over an extended period, prior to rolling out the national programme in its entirety to both RSLs and non-RSLs in 2008-10.

The timescale for developing and introducing the new systems was, in our view, too tight. The resultant overlapping of the NPiaH and NAHP evaluation and bidding processes reduced the likelihood of learning lessons from NPiaH in time for the NAHP bidding round.

Whilst the initial emphasis was on capturing the benefits of involving new providers and streamlining the supply chain, the subsequent emphasis on protecting the public interest limited the prospects of fully achieving those benefits.

The selection process for non-RSL bidders was rigorous and logical.

Non-RSLs were more successful in the NPiaH bid round than in NAHP, with a success rate of 49% based on bid value, compared to 22% in NAHP. This was probably due to a more limited take-up by non-RSLs in NAHP, and a selection process in NPiaH that may have focused more on value for money than strategic fit.

Non-RSLs found the systems, and particularly the Investment Management System (IMS), challenging. They have been critical of the complexity of the decision-making process, and the amount of information required at an early stage in the bidding process. They have also been critical of a perceived inadequacy of feedback on unsuccessful bids. Nonetheless, a mixed economy of providers of affordable housing is now beginning to develop.

The Corporation has exceeded the national efficiency gain targets (compared to the 2003-04 programme) for new supply set for 2006-07 (£140 million) and 2006-07 (£160 million) in the NAHP, which were established as part of the Gershon review process.

A direct comparison between the national average grant per unit on the NAHP programme and that of previous years (excluding nil-grant schemes) appears to show a reduction in the headline grant levels of 7% on the rented programme and 13.6% on the LCHO programme. When the Laspeyres methodology is applied, average savings are demonstrated of 4.7% on rent, 7.7% on low-cost home ownership and 11.3% on intermediate rent. However, there are differential impacts on land costs of opportunistic pricing from land banks and Section 106 conditions. This suggests that it cannot conclusively be stated that the savings result from supply chain improvements or increased competitive pressures. Furthermore, it cannot be determined whether any differences in value for money between RSLs and non-RSLs result from lower land costs or from other factors.

In order to increase interest from new providers, and to maximise the benefits of their involvement, it may be that a more radical approach is necessary in relation to streamlining systems and uncovering ways in which risks and rewards are shared. Indeed, in our view, it will be necessary to make changes to the bidding process and/or introduce in-year bidding. This is a reflection both of commercial developers' ability to pursue options other than affordable housing, and the reality of the process of development of large and complex multi-tenure schemes.

It is plain that although the majority of negotiations have been completed in a short space of time (for instance compared with typical periods for Private finance Initiative deals), there remains dissatisfaction amongst non-RSLs about the terms of the Grant Agreement. This suggests that non-RSLs have 'taken a view' on an agreement relating to a relatively small programme, rather than being satisfied that the terms represent an acceptable basis for a long-term relationship. By definition, the non-RSLs that have taken part in the NPiAH and NAHP, and have been awarded grant, are drawn from those that have been prepared to tackle this new programme. Equally by definition, other non-RSLs that have chosen not to participate in these new programmes, are less certain of the benefits of doing so. It may be harder to persuade current non-participants to do so in the future, if they perceive that their colleagues and competitors are unhappy with the terms of the Grant Agreement.

Although a real start has been made, a process of positive engagement with a wider range of commercial organisations, and in particular property investment or management companies, is necessary to attract new players. At present, the new approach to investment has attracted little interest other than from house builders that see it as an adjunct to the development of sites for market value sale.

## Recommendations

The Corporation should engage in a carefully planned, long-term programme of developing relationships with non-RSLs in order to understand better their business drivers and to elaborate on the requirements of the new approach to investment to encourage their participation. This programme should aim to increase engagement amongst investors, private property managers and large-scale commercial developers, as well as the house builders that are already engaged.

A bidding process should be developed which is more closely attuned to the realities of the private development process, particularly in relation to large, complex, multi-tenure and mixed use developments. This is likely to involve:

- a two-stage bidding process, the first stage of which will establish regional fit and ‘in principle’ commitment on the basis of less detailed information than the current system requires – only if proposals pass that stage would more detailed information be required;
- the flexibility to bring sites forward as and when available, rather than having to fit into a biennial bidding cycle; and
- forward commitment to strategic housing schemes whose development lies partially or wholly further in the future than the current budgeting regime.

Grant conditions should be reviewed, in order to enable a greater sharing of risk and reward between the Corporation and non-RSLs. This should facilitate a collaborative framework of procurement, which overcomes current adversarial relationships, and promotes risk sharing and team work to sort out problems together.

In conjunction with the amended bidding process suggested above, an open book approach following in-principle commitment should form an integral part of this. In order to respect the commercial confidentiality of cost information provided under the existing system, and the danger that such information may be disclosed as a result of the provisions of the Freedom of Information Act, a different approach to project appraisal is outlined below.

These improvements to the system should apply equally to RSLs and non-RSLs. The use of different regulatory systems for organisations providing and managing social housing is not sustainable in the longer term, and if a contractual approach is to be maintained for non-RSLs, then such an approach should also apply to RSLs. This will require:

- setting out minimum standards of product, service and procurement processes, which are consistent between RSLs and non-RSLs;
- loosening restrictions on RSLs, and thus a less prescriptive approach to their regulation.

A network of ‘regional champions’ or ‘centres of excellence’ should be developed across the Corporation’s field offices, to disseminate knowledge and improve understanding of the system objectives and tools, among both Corporation field staff and bidders alike.

The bidding and appraisal process should be streamlined to enable an ‘in principle’ decision to be made more quickly and on the basis of less information, as outlined above.

Consideration should be given to developing a rolling bid process to avoid the concentration of activity over a very short period.

For partner organisations (whether RSLs or non-RSLs), allocations should be for a programme rather than individual schemes, and should provide a framework that allows flexibility without

breaching the requirements for resource accounting. Such a programme agreement could set parameters (timescale, locations, average grant requirements, etc) and guarantee that, in return for a minimum level of grant from the Corporation, the bidder will provide a minimum number of dwellings. That would be the allocation. However, the agreement would also contain a 'reserve schemes list' and set parameters for substitutions or additions to the programme. The programme could then be managed with both parties comfortable in the knowledge that there was a pool of acceptable substitutes should one of the initial schemes be delayed or fail. Establishment of a programme agreement such as this would allow greater emphasis to be placed on longer-term, strategic schemes.

The basis of scheme appraisal should be value as opposed to cost, at least for added stock. This would allow the valuation impacts of Section 106 conditions to be recognised in the appraisal of value for money of proposals. It would also help overcome concerns amongst non-RSL bidders about the disclosure of commercially sensitive information under the Freedom of Information Act. Bids would provide the open market vacant possession value (i.e. with no constraints on user) and open market value (i.e. investment value taking account of any constraints on user resulting from Section 106 or site acquisition conditions). Grant would then be expressed as a percentage of the unencumbered open market vacant possession, and any clawback provisions in the Grant Agreement could then simply be the same percentage of a new open market vacant possession at the time of disposal or transfer. In order to establish such a system, discussions should be held with the Royal Institute of Chartered Surveyors to review the 'Red Book'.

Assessment and selection criteria should be more prominent and clearly understood by bidders. Subject to any changes arising from the above recommendation, information on the operation of the Grant Index tool and the Grimley model should be available so that bidders could self assess prior to submission of bids.

The technological infrastructure available to bidders and Corporation field staff should be improved. This would require improvements to IMS and better integration of data to avoid any double-entry.

If the recommendations are adopted on streamlining the bidding and appraisal process to enable an 'in principle' decision to be made more quickly and on the basis of less information and on making value rather than cost the basis of scheme appraisal should, then the requirement for detailed financial workbooks would no longer apply at bid stage. Even if these recommendations are not accepted, financial workbooks should either be abandoned or the amount of detail drastically reduced. If they are retained, in whatever form, then they must be designed and operated in a manner that is linked directly to IMS data and/or bidders' own data systems.

If the recommendation is adopted on reviewing grant conditions to enable a greater sharing of risk and reward between the Corporation and non-RSLs, then the terms of the Grant Agreement should be simplified radically. Specifically, requirements for collateral warranties should be removed, relying instead on defects insurance such as NHBC, or Third Party Rights Act.