

Cave review of affordable housing regulation

Response of the Housing Corporation

February 2007

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Executive Summary

- The Housing Corporation believes that the time is right for a fundamental review of social housing regulation.
- We consider that the primary roles of social housing regulation are:
 - to ensure a fair system of allocation of a scarce resource
 - to set parameters for the price at which the scarce good should be made available
 - to protect residents in terms of the quality of housing services they receive given that they have a relative lack of choice both in terms of home and provider
 - to protect the interests of the tax-payer in terms of the 'return' they receive on the capital and revenue resources invested in social housing, and the embedded historic investment in the asset base.
- We consider that the current regulatory system has been successful in facilitating the expansion of the housing association sector in providing new homes and managing existing stock at relatively low cost to the State.
- We do not believe that the current system will be fit for purpose going forward in the context of a mixed economy of providers, a rapidly diversifying sector, a greater emphasis on customer empowerment and the desire for further de-regulation.

- Our vision for a new regulatory system is based on a refreshed relationship between the affordable housing provider and the consumer, ensuring excellence in delivery of housing services whilst also incentivising providers to offer a range of other 'added value' services to their customers.
- We consider that the objectives of the new system should be:
 - address market weakness by
 - increasing the supply of and improving the standards of social housing by enabling private investment and supporting and protecting public investment
 - enabling a more dynamic social housing sector to provide for those who cannot meet their needs in the un-subsidised market, encouraging entry into the market and enhancing market mechanisms as a whole
 - drive service performance
 - promote consumer choice, influence and redress within the structure
 - build a coherence of interests between government, providers and consumers
 - minimise the costs of regulation and information burdens for the regulated bodies and the regulator
 - ensure that regulatory activities are undertaken by the most appropriate party, be that the consumer, local authority, provider (through the audit mechanism) or by the statutory regulator
 - keep private provider borrowing off the PSBR
 - embody the principles of Better Regulation.
- We believe that the new system should have the following features:
 - clear statutory objectives and duties for the regulator, including a clear 'principal regulator' role to co-ordinate the overall regulatory burden on the sector

- an explicit mandate for incentivising efficiency and capacity utilisation
 - clear boundaries between the principal regulator, the sponsoring Government department and other agencies
 - lighter and more strategic regulation, focused on defining key standards and desired outcomes, and then monitoring delivery
 - a 'looser fit' framework to enable easier access to the market by different types of provider, albeit with clear expectations of high service standards
 - sharper and more responsive intervention powers, for example to manage performance failure
 - well-defined, well-managed interface with the investment function, to protect and optimise public funding
 - control of inspection with the regulator
 - consistent, transparent performance measures for the regulator
 - an emphasis on promoting best practice
- We consider that these criteria will be best met by a brand new registration system for social housing providers with the following characteristics:
 - open to all private affordable housing providers, profit-making and non-profit making
 - encompassing the ownership and management (but not the development) of social housing assets and associated services
 - a regulatory approach that focuses on the social housing activities of the registered body and the assets underpinning that activity...

- ...based on a statutory re-definition of what constitutes the core purposes of a social housing provider to reflect wider community needs, interests and concerns
 - the task of the regulator would be substantially simplified and reduced, with more emphasis on defining expected standards and outcomes, with providers developing their own certified systems of risk management and consumer accountability in pursuit of those expectations
 - there would be a new explicit statutory role for the regulator to influence efficiency in the use of social housing assets and associated provision of services, including a devolved responsibility for rent pricing.
- In addition, the new system would include:
 - a limited regulatory role for local authorities over registered providers to allow strategic oversight of local concerns such as neighbourhood management and anti-social behaviour
 - a new framework for consumer empowerment including a new collective right to change housing manager
 - a new toolkit for the regulator to intervene when things go wrong
 - a new inspection framework based on risk assessment and customer priorities
 - a simplified regulatory approach for smaller organisations but within the same registration framework.
 - We consider that a registration system with these characteristics will provide a more flexible, responsive and efficient system than either a contract or licence-based approach. We also reject a system built mainly on self-regulation as insufficient to protect resident and tax-payer interests, although we do envisage an expanded role for self-certification of performance within the new regulatory framework.
 - In considering the institutional arrangements to manage the new system, we want a regulator with the following characteristics:

- able to promote a strong consumer ethos, with a focus on promoting resident opportunity, choice and value through the regulatory system
 - a culture that is attuned and empathetic to regulating private sector organisations with a Board and Executive that understand and can respond to the financial and governance context in which private providers are operating
 - a dedicated and expert focus on housing and related issues, with a lean professional team combining relevant professional skills - economic, consumer services, financial and supervisory
 - an operational emphasis on seeking assurance on frameworks and processes, with a move away from direct provider engagement as the norm
 - a positive, enabling culture that promotes provider development and diversification, commensurate with sustainable use of assets and resources
 - the expertise and intent to enhance the interface between the regulatory framework and public investment in social housing - both capital and revenue.
- We consider that, on the balance of evidence, there continues to be a strong case for co-location of investment and regulation functions. While we can see how a separated system could work, we consider that the burden of proof is firmly on those who would prefer a separated system to show how the benefits would be greater than the historic performance of a co-located approach.

Introduction

1. The time is right for a fundamental review of social housing regulation and the Board of the Corporation welcomes the approach that the Cave review team is taking.

2. This document is the Board's submission in response to the Call for Evidence and it:

- examines the context for regulation of the HA sector
- sets out our thinking on the objectives that a new system for regulation should have
- describes our preferred option for how the sector might be regulated against these objectives
- comments on the possible institutional and transitional arrangements.

We have woven through our response our views on the specific questions posed in the Call for Evidence.

3. The response is based on the Corporation's work over the last nine months since the conclusion of the Elton review. This work has included comparative analysis of other models of regulation, both in other sectors and overseas. We do not repeat this work here but refer the reader to the following documents which are on our website and have been submitted to the Cave review earlier in the process:

- 'Report on the Future of Regulation of Affordable Housing in England' - CIH/Tribal HCH/Cranfield University
- 'Comparative Review of Regulation Systems' - Housing Corporation and Tribal HCH

Context

4. As context for thinking about the future of regulation, it is useful to consider:

- the purpose of regulation
- the existing approach to regulation, its successes and limitations

Why regulate?

5. The social housing sector exists primarily because of an inability of the market, subject as it is to planning constraints, to supply housing at a price that everyone can afford to pay. This includes significant amounts of housing that is designed to accommodate households with particular support needs.

6. Social housing is therefore subsidised housing and is itself a scarce resource where, in most locations, demand outstrips supply. The primary roles of regulation are therefore:

- to ensure a fair system of allocation
- to set parameters for the price at which the scarce goods should be made available
- to protect residents in terms of the quality of housing services they receive, given that they have a relative lack of choice both in terms of home and provider
- to protect the interests of the tax-payer in terms of the 'return' they receive on the capital and revenue resources invested in social housing, and the embedded historic investment in the asset base.

7. Regulation has also played some additional roles in the housing association sector of benefit to the State and others:

- it has acted as a source of accountability in the absence of shareholder discipline or democratic oversight
- it gives confidence to the lending community in both the levels and costs of borrowing
- it protects the reputation of the large majority of providers by dealing with failure of the few
- it has enabled Government to deliver policy commitments through private organisations, in most cases without additional legislation
- the registered status (and the regulatory system that sits behind it) is used by providers as reputational collateral in attracting other sources of public and

private funding, particularly for wider community initiatives

- it facilitates the supply of new homes by incentivising the use of resources and asset strength of the sector for this purpose
- it can help preserve competition, for example, by preventing monopolies developing in a particular locality or in relation to a specialist type of accommodation.

8. What this list of objectives and benefits immediately demonstrates is that there are trade-offs at the heart of any regulatory system and particularly in respect of a sector as complex and diverse as social housing where there are multiple economic and social objectives at stake. Some examples of this are as follows:

- there is an inherent tension between downward pressure on price to ease affordability with the desire to create and release more provider investment capacity to build more new homes
- there is a trade-off between enabling consumer choice over who manages their home and the desire to drive efficiency in how stock is managed, for example through rationalisation of providers within a geographical area
- there is a tension between seeking to reduce the regulatory burden on providers while maintaining lender and consumer confidence in the system of provision
- there is a trade-off between Ministers' desire to passport policies to providers on behalf of customers and tax-payers with providers' desire to reduce risks of uncertainty and therefore the cost of provision.

9. These tensions between the interests of consumer, tax-payer, provider and investor are inherent within the system of provision. It means that in this review there are no easy answers, no silver bullet. This review is therefore engaged in a relative process of choosing the systemic approach that will enable the best possible combination of economic and social outcomes from the provision of affordable housing, while recognising that the desired balance of outcomes will inevitably change over time. Therefore, our first requirement of any regulatory system is that it provides a

framework in which these policy choices between the balance of interests can be made and adjusted flexibly while maintaining confidence in the overall system of oversight and control.

What has regulation achieved to date?

10. Looking at achievements to date helps to demonstrate the value added by regulation under the current statutory framework. Regulation has contributed to:

- enabling leverage of over £35 billion of private investment into social housing, outside the PSBR
- creating a climate of lender confidence where loan interest rates are currently some 60 basis points lower than those available to private sector house-builders
- facilitating the delivery of an investment programme of over £8 billion in the last ten years, with completion targets met every year
- implementing Government's rent convergence policy coherently and affordably
- delivering other important policy targets in social housing, including the Decent Home Standard
- enabling the transfer from local authorities and improvement of nearly one million homes, with investment of over £10 billion outside the PSBR
- ensuring that residents, taxpayers and lenders have not suffered as a consequence of organisational failure by housing associations.

11. In short, regulation has delivered a stable sector, where poor performance can be quarantined and addressed, producing an overall low risk profile which encourages inward investment from mainstream lenders. In balancing interests and generating a mix of desirable outcomes, the current regulatory system has performed well.

Why reform?

12. These achievements are considerable but they mask changing needs that the current system would struggle to address.

13. Over the next decade, we are likely to see:

- increased diversity in type, scale and scope of operation of social housing providers, with several landlords owning and managing over 100,000 homes, alongside a diminishing but still very significant number of small organisations providing specialist and/or local accommodation and support services
- increasing diversity in housing providers and their activities; some organisations will want to develop as broad social investment agencies, with social housing as only a part of their businesses
- continuing focus on the consumerisation of public services, with concepts of choice, accountability and redress at the heart of any State-backed system of provision
- an increasing emphasis on place-making to be reflected in the new investment relationship between local authorities and Communities England, and also in broader expectations of accountability of bodies providing public services to the communities they serve
- an international market in the provision of affordable housing development and services and greater EU interest
- a continuing drive towards de-regulation, to facilitate innovation and enterprise through sensible risk-taking.

Our vision

14. Our vision is of a different affordable housing sector to the one we see today, with a wider range of organisations offering an excellent affordable housing service to their customers. In many cases, it will be only one of several related services they offer. Some will wish to develop their competence in tackling worklessness, others in education, yet others in public health. We therefore need a regulatory system that ensures excellence in core

housing services but does so without stifling the growth and development of the sector in these other areas of provision.

15. Our vision sees the provision of affordable housing as both a public service and a personal service. We believe that an affordable housing service that provides a stable platform from which individual residents can access economic opportunity and improve their social welfare is also very much in the public interest.

16. We believe that in the past, an over-emphasis on bricks and mortar has tended to cloud the fact that the provision of social housing is a service, no different in most respects from other public services such as social care or education. At its heart should be a provider-customer relationship where the provider strives to maximise standards of service and provide choice over how the service is delivered.

17. The current system of regulation focuses too much on the provider and not enough on the customer. It reflects a historic, more paternalistic culture of State provision where customers were too often the passive recipients of a given set of services, a culture that has sometimes contributed to dependency, rather than promoting opportunity.

18. That is, fundamentally, why we need a new statutory regulation system for social housing. We need a system that sets clear service outcomes based on high performance standards. We need a system which ensures that not only can consumers demand that the basic services are provided well but which also incentivises providers to partner their customers in accessing a wide range of other services alongside their tenancy. And we need a system that ensures that providers use tax-payers resources as efficiently as possible. It is this type of regulatory system that the rest of the document seeks to define.

Objectives of the new system

19. Having regard to all of the above - the rationale for regulation, the achievements of the current system and our description of future needs - we would suggest that the fundamental objectives of the new system of regulation should be to:

- address market weakness
 - o increase the supply of and improve the standards of social housing

- o enable a more dynamic social housing sector to provide for those who cannot meet their needs in the un-subsidised market, encouraging entry into the market and enhancing market mechanisms as a whole
- o promote growth in the overall supply of housing by enabling private investment and supporting and protecting public investment
- drive service performance
- promote consumer choice, influence and redress within the structure
- build a coherence of interests between government, providers and consumers
- minimise the costs of regulation and information burdens for the regulated bodies and the regulator
- ensure that regulatory activities are undertaken by the most appropriate party, be that the consumer, local authority, provider (through the audit mechanism) or by the statutory regulator
- ensure that private provider borrowing stays off the PSBR
- embody the principles of Better Regulation.

20. Certain practical limitations on the Corporation as regulator under the existing arrangements should also be addressed including:

- the fact that the existing powers contain no clear mandate for efficiency
- a lack of flexibility to promote a mixed economy of providers and to encourage new markets
- inadequate interface between regulation and inspection
- the fact that, due to the limitations of current statutory powers, intervention is slow and costly and lacks the agility which residents and the market need.

Defining a new approach

21. Based on the above objectives or principles, we have identified what we consider to be some essential characteristics of a reformed system. It should acknowledge the distinctiveness of the sector and have the following features:

- clear statutory objectives and duties for the regulator, including a clear 'principal regulator' role to co-ordinate the overall regulatory burden on the sector
- an explicit mandate for incentivising efficiency and capacity utilisation
- clear boundaries between the regulator and both the sponsoring Government Department and other agencies
- lighter and more strategic regulation, again focused on defining and key standards and desired outcomes, and then monitoring delivery
- a 'looser fit' framework to enable easier access to the market by private providers, albeit with clear expectations of high service standards, thus encouraging new entrants;
- sharper and more responsive intervention powers, for example to manage performance failure
- well-defined, well-managed interface with the investment function, to protect and optimise public funding
- control of inspection to be with the principal regulator
- consistent, transparent performance measures for the regulator
- an emphasis on promoting best practice.

22. These components can be shaped and linked in a number of ways, depending on how Government sees the trade-offs and how best the benefits noted above can be realised. We have considered a number of models ranging from a modernised version of what we already have through to a radically different activity-based licensing system.

23. The Cave Call for Evidence invited discussion on three possible models:

- reforming the current framework
- licensing/contract based approach
- self-regulation.

The tables at Annex A summarise our views on these options, including the advantages and disadvantages.

24. Having considered them, we have identified a fourth option that we believe may be most likely to deliver against the criteria we have set. Its central component is a brand new registration system with the following characteristics:

- open to all private affordable housing providers, profit-making and non-profit making
- encompassing the ownership and management (but not development) of social housing assets and associated services
- a regulatory approach that focuses on the social housing activities of the registered body and the assets underpinning that activity...
- ...based on a statutory re-definition of what constitutes the core purposes of a social housing provider to reflect wider community needs, interests and concerns
- the task of the regulator would be substantially simplified and reduced, with more emphasis on providers developing their own certified systems of risk management and consumer accountability
- there would be a new explicit statutory role for the regulator to influence efficiency in the use of social housing assets and associated provision of services.

25. We are therefore describing a very different registration-based system from the one that currently exists. One of the main differences is that it will have embedded within it significant elements of self-certification of standards and performance.

26. The following sections expand on this option.

Why a registration system?

27. Over the last six to nine months we have explored a number of alternative regulatory models and in particular, the replacement of a registration system with either a contract or licence-based approach. The essential difference is that the latter approaches focus on the activity being procured or sanctioned, with a much weaker interest in the provider organisation. We can see attractions in these alternative models from a provider perspective, in that they provide greater certainty over compliance requirements which in turn makes it easier to price those requirements accurately over a period of time. A contract or licence-based system would also make it easier to operate a common system of regulation, irrespective of type of the type of provider.

28. However, from a customer and tax-payer perspective we consider that a registration system has strong advantages over a contract or licence-based system, in particular:

- the ability of the Government to passport policies to providers as operating needs and circumstances change, rather than having to renegotiate terms
- to allow Government to retain adequate control over the use of assets historically funded by tax-payers
- to enable a light touch approach to regulating the majority of providers with the security that comes from an incremental approach to intervention to rectify performance failure
- comparatively low transaction costs.

29. Moreover, we have not been able to define a contract or licence-based system that would easily enable the transfer of existing grant-aided assets into that framework. Unless this legacy issue could be resolved satisfactorily, it could mean that Government would have to write off its interest in those assets. Although this is an approach that has been adopted elsewhere, e.g. Netherlands, we do not believe it is acceptable or desirable from a tax-payer's perspective.

30. Although we are very clear in our main conclusion that we prefer a registration system, we do recognise that a contract-based approach will be at the heart of the investment function of

Communities England. We therefore also conclude that the revised registration system should be restricted to the ownership and management of social housing assets and services. At the same time, the legislation to create Communities England should empower that organisation with the freedom to invest in new (and existing) social housing through a variety of means - grant, loans, PFI credits etc - including the ability to restrict grant to registered social housing providers in circumstances where this would be useful to it without breaching EU competition rules. Where such assets were developed by non-registered organisations, they would have to transfer to a registered organisation upon completion, irrespective of how they were funded and including through section 106 agreements.

To whom should the new system be applied?

31. The terms of the Cave review opened the possibility of defining a regulatory system that would cover all social housing providers - public and private. Our view is that it is important that all social housing customers should have essentially the same rights, opportunities and performance expectations regardless of the nature of their landlord. We do not consider, however, that this means that all providers must fall under the same regulatory system.

32. From a consumer perspective, we want to see a situation where all social housing tenants can have the same expectations over quality of service outcomes:

- equality of tenancy rights (as explored recently by the Law Commission)
- access to meaningful comparative performance information
- some element of choice over who provides their management services (see para. 33 below)
- equivalent rights of redress and complaint.

33. Therefore, while we consider that all providers should be subject to the same levels of service requirement, we do not consider that it is appropriate to subject public providers (essentially local authorities and ALMOs) to the same type of regulatory oversight as private providers. To do so would fail to recognise the essential differences in the governance arrangements

of public and private providers. If carried to its logical conclusion it could even undermine the local government model of democratic leadership and accountability. It could also blur the distinction between public and private borrowing, with potential PSBR consequences. (The one caveat in this conclusion is uncertainty over the future status of ALMOs if they start to operate outside the HRA framework, but this would depend on the system of governance and, in particular, their level of accountability to the local authority.)

34. At the same time, we would want to see a single registration system that can accommodate all types of private providers, profit-distributing and non-profit distributing. In creating this much more liberal system of registration, the main requirement from the Corporation's perspective would be to ensure that the relevant assets were used for clear social housing purposes to ensure continuity of high quality supply.

What would be regulated?

35. We believe that the regulation system should focus on social housing assets and services. The current definition of 'permissible purposes' of registered housing associations is actually already very wide (Housing Act 1996 section 2(4)). We do not consider that social housing regulation should regulate against all the activities that would fall under these purposes, many of which are covered by other regulation or inspection systems. At the same time, we consider that the new system should adopt a definition of social housing provision that focuses more broadly on quality of life issues over which the provider has some influence. The key areas where we consider that the regulatory system should focus are:

- housing management and maintenance services
- asset management and financial viability
- consumer empowerment
- co-operation with local authorities on neighbourhood management, including addressing anti-social behaviour
- co-operation with local authorities on preventing and addressing homelessness and housing allocations policies
- promoting environmental sustainability

- promoting efficiency and value for money.

The regulatory task

36. Under the revised registration system, we would not envisage the regulator engaging in the same type of day-to-day relationship management that the Corporation has pursued with Registered Social Landlords under the regulatory code. Instead we would see the regulator's role as restricted to:

- ensuring that the activities of the registered bodies remain within a broad overall set of permitted purposes
- ensuring through a system of self-certification that registered bodies had the frameworks in place to ensure that they were meeting the a limited set of regulatory requirements, as embedded in statute and statutory guidance
- ensuring that customers have access to the information they require to exercise their rights
- using a small set of economic intervention tools to ensure that providers are acting efficiently in their use of assets and management of services
- publishing a simple annual report on each provider above a certain size, assessing their performance comparatively based on available data sources, but particularly PI data
- using an incremental suite of powers to intervene to investigate where there is evidence that things are going wrong and to put things right when they are going seriously wrong.

37. We deliberately use the term self-certification rather than self-regulation. We consider that providers should be given more responsibility to establish the right governance and accountability frameworks for themselves, in consultation with customers and other stakeholders. However, we consider that these frameworks must be rooted in the statutory system to allow the regulator to take action when things go wrong. This is necessary not only to provide protection for customer and tax-payer, but also to ensure that private lenders retain confidence in the system. In order to

provide the necessary regulatory assurance, we envisage an expanded and enhanced role for the auditors of the registered bodies to provide assurance that providers continue to have the necessary systems and resources in place to deliver the required service outcomes.

38. We would also expect an increase in the use of benchmarking and peer review as additional means of providing performance information and assurance.

39. The overall impact of this revised approach should be a significant reduction in the regulatory burden for all providers with far fewer information requests and strategy requirements, and far less day-to-day engagement with the regulator. Indeed, many well performing registered providers with good systems in place should not have to see the regulator from one year to the next. This major reduction in burden from the national regulator will be offset to some extent by an increased accountability to residents and local government, but the net effect should still be one of substantial de-regulation.

The role of economic regulation

40. We consider that the regulator of the registered organisations should have a central role in influencing the efficiency of those organisations in the way they use their resources and capacity. To underpin this role, we believe that the regulator, not Ministers, should be responsible for pricing decisions. Under this model, legislation and periodic statutory guidance would set pricing objectives in terms of affordability, efficiency, financeability and quality of services. The regulator would then set the rent formula for a given period, allowing for relevant factors - such as geographical and service differences - that in its judgement would be most likely to achieve the Ministerial objectives. At the same time, the regulator would have to ensure that providers were using resources and asset strength productively. There are a number of tools that potentially could be used to achieve this including the pricing mechanism, incentives (carrots and sticks) related to performance, and, in extremis, statutory direction. We would encourage the review team to explore the best option or options.

41. There is a secondary economic role for the regulator which is to promote competition in the provision of affordable housing services. This can have both a defensive element, e.g. preventing monopolistic positions arising in the market-place, but also a

positive approach, e.g. reducing barriers to entry, promoting customer choice.

Policy passporting

42. We are recommending a system that will best accommodate the ability of Ministers to channel new or revised policies through providers to achieve outcomes on the ground. However, we also consider that it would be advantageous if some discipline over use of the passporting mechanism could be built into the system so there is no longer reliance by the Government on voluntary assimilation of policies by providers.

43. One model that might achieve this discipline, (and which borrows from our thinking on rent-setting), would be for Ministers to have the power to issue periodic statutory guidance to the regulator on important policy requirements. The guidance would be subject to full consultation and all policy proposals within the guidance would need to have been costed. Once Ministers' guidance had been formally issued, the regulator would then issue formal statutory notice to registered providers of changes to their regulatory requirements and would give them a reasonable period of time to adapt their operational practices and certification frameworks. At the same time, the regulator would be under a duty to reflect these changes in policy requirements in considering future rent pricing and efficiency requirements.

44. Although we recognise this is not the only model that will achieve this end, the principle is clear. If we want to see an increase in the number and range of social housing providers, particularly private companies, under this new system, they must be able to price sensibly the risks of entry. Similarly if we wish to encourage innovation in the use of resources and assets by existing providers, then we need to maximise certainty in the continuity of a stable set of regulatory requirements.

Customer empowerment

45. The current regulatory system uses regulation and inspection in part as a proxy for consumer influence. In the reformed system, we would like to see actual power transferred direct to the consumer. There are a number of ways of achieving this and the following merit further exploration.

- Resident scrutiny committees : as part of corporate governance structures
- Performance standards: giving residents the ability to agree local performance measurement and reporting frameworks with their landlords based on their own identified priorities
- Resident-led inspections: these could range in ambition from environmental quality audits through to full service inspections
- Community asset ownership: incentives for registered bodies to endow residents' groups with assets to develop community ownership and services
- Compensation frameworks: establishing an expectation that providers pay residents compensation where service falls below a certain level (with potentially the supporting ability of the regulator to direct that compensation be paid)
- Choice of manager: this will probably work only on a collective basis at estate or neighbourhood level. It would also require the removal of VAT charges on management contracts between registered providers. The choice might include establishing a TMO, moving to another registered provider or selecting a local authority or ALMO.

46. In selecting from these and other options it will be important to ensure that we do not create a context where it is too easy for the vocal minority to hijack an agenda at the expense of the greater community good.

47. We envisage that each provider would be under a regulatory requirement to establish a compact or framework for consumer empowerment, with the regulator acting as a 'remote back-stop' or 'final arbitrator' of the implementation of that framework.

48. In making these proposals we also consider that the review team should look closely at the role and functions of the Housing Ombudsman to see how these would fit best with a more consumer-driven regulatory system.

Role of local government

49. The recent Local Government White Paper envisaged local government playing a stronger strategic housing role as part of their overall contribution to place-making. The expectation is that the authority will consider all housing needs for their locality and deploy powers, functions and partnerships to meet those needs. With housing associations now owning and managing over half of all social housing stock, most local authorities are reliant on those private providers not just to meet housing need but also to pursue excellence in neighbourhood management, tackle anti-social behaviour and promote community cohesion. The quality of private providers' contribution to these essential objectives is, in our opinion, better assessed at the local level rather than from the perspective of a national regulator who is inevitably at least one step removed. That is why the Housing Corporation is currently introducing a formal mechanism to allow local authorities to comment on the local performance of registered providers on issues of local concern.

50. An enhanced local authority role would need to be carefully tested to ensure that it did not negatively impact registered bodies' status as private bodies for public accounting purposes, but subject to this test, we believe that the reform of the regulatory system could go further by considering adopting one or more of the following:

- placing registered providers under a duty to co-operate with the local authority on a defined set of relevant issues where they are operating in their locality; (this would broaden the current duty which relates strictly to addressing statutory homelessness)
- making registered bodies subject to scrutiny by local authority scrutiny committees on a defined set of relevant issues
- giving local authorities some influence over the local performance measures utilised by housing associations to allow ready comparison of local housing provider performance
- including scrutiny of registered bodies' contribution to community welfare within Comprehensive Area Assessments when they replace CPAs; (this should probably be limited to registered bodies that have a critical mass of stock in an area, e.g. LSVT)

51. Our perspective on the strategic role of local government and its relationship with registered providers complements our view that the regulatory system should be restricted to private housing providers of social housing services.

Role of inspection

52. Over the last few years, the inspection process has played an important role in driving up standards of housing management across social housing providers. For ALMOs, a key driver has been the ability to access Government capital funds if they achieve a particular level of performance. For housing associations, the main incentive has been a negative one in that a poor inspection result could lead to a loss of a regulatory green traffic light, possible supervision action and loss of development partner status.

53. Nevertheless, there are some significant flaws in the current inspection system that need to be addressed:

- one of the main benefits of the current system is meant to be that it provides a basis for comparison. However, it fails to do so accurately because providers are often inspected years apart, the inspection only covers a proportion of the service for larger providers and the Key Lines of Enquiry do not always match the diverse range of provider service priorities; the current comparative star grading system is therefore only of limited benefit
- inspection does not operate as a tool of the regulator in that the regulator has no control over how or when it is undertaken as this is determined by a different statutory body, albeit in consultation with the regulator. Instead, the interface relies on goodwill from the Audit Commission towards the Housing Corporation as the regulatory body. We do not consider that it is good practice for a statutory regulator to be constrained in this way
- there is some duplication of effort between regulator and inspector, particularly in the areas of governance and resource efficiency
- the current programme approach of periodic whole service inspections is not fully risk-based and is

currently unsustainable in terms of available public funding.

54. We consider that inspection has an important but different role to play under the revised system. We would like to see:

- all registered providers over a certain size to be responsible for commissioning their own programme of service area inspections against a risk-based framework agreed with the regulator and residents;
- these inspection frameworks would need to include an element of external inspection, perhaps from a panel of accredited providers, but could also include some facilitated resident inspection
- the implementation of the inspection framework should perhaps be paid for by the provider, not the State
- the power to inspect would also be available to the regulator as one of a suite of intervention powers to be used forensically on a risk basis to explore and illuminate service problems.

55. Consequently, the powers of regulation and inspection would be re-integrated into a single regulatory body, albeit that the regulator would almost certainly choose to sub-contract the process of inspection itself when that power was used.

Intervention powers and sanctions

56. The terms of reference for this review require a response that safeguards the flow of private finance into the provision and upkeep of the social housing stock. Most critical in this respect is the ability of the regulator to take proportionate action to safeguard the interests of tenants and tax-payers when things go badly wrong.

57. The current set of powers available to the Housing Corporation are inadequate for this purpose. The main fault is that there is no balance in the range of powers with a significant gap between a relatively light power of being able to appoint a Board Member and the so-called nuclear option of a full statutory inquiry, potentially leading to the enforced transfer of assets.

58. In considering the package of powers we need to avoid too interventionist an approach that would call into question providers'

borrowing status as private bodies. There is also the difficulty of applying powers to the governance structures of large bodies where the provision of affordable housing services may only be one small part of their activities. But despite this concern we do consider that a more balanced package of intervention powers and sanctions is required that would probably include powers to:

- direct a registered body to provide information
- direct a registered body to rectify a failure against a statutory duty or other regulatory requirement
- order a provider to make restoration to a resident or residents, including potentially financial compensation, where a regulatory breach has had a materially negative impact
- direct a provider to commission its own independent investigation
- enable the regulator to commission its own investigation, including the power to inspect
- appoint Board members (noting this may become difficult in the context of a wider set of private providers)
- direct a registered body to appoint a special manager to address significant areas of failure
- step-in rights in case of potential insolvency
- commission a statutory inquiry leading potentially to enforced removal of staff (and Board members), and ultimate power to direct transfer of assets and undertakings.

Stock transfers

59. One of the significant advantages of the simplified and broadened registration system that we are proposing is that it will not only enable the stock transfer programme to continue without major reform but it will also increase the number and type of organisations, existing and new, that a local authority and its tenants can consider.

Small providers

60. The Corporation currently operates a streamlined Regulatory Approach for Small Associations (RASA) for organisations with less than 1000 homes and regarded as low risk. These constitute almost 70% of all housing associations and they experience much lower burdens in terms of day to day regulatory engagement and information provision. They are also not normally subject to external inspection.

61. We could conceive a regulatory system which excluded these organisations, effectively writing off the public debt embedded in their assets. We do not, however, propose this approach as it could result in a situation where a resident of a smaller housing provider had a lower level of regulatory protection than a resident of a larger provider. We therefore consider that the new system will have to adopt a similar 'abridged' set of requirements for smaller organisations. At the same time, in circumstances where it makes sense on efficiency and service delivery grounds, we should provide incentives for these organisations to combine their asset strength with that of larger providers, for example, by joining a group structure.

Provision of comparative performance information

62. At this stage of our response we need to perform a reconciliation. Our preference is for a regulatory system restricted to private providers, but we also want residents to be able to assess the comparative performance of different local housing providers - both public and private - and to have reasonable expectations that they will get comparable service, irrespective of type of provider. We believe this can be achieved by the following:

- ensuring that we have a single system at national level for the collection of performance information (potentially through the National Register of Social Housing which could be administered by the regulator)
- ensuring all providers are placed under the same set of requirements in respect of consumer empowerment
- adopting a version of the Law Commission's proposals to create a single long term social housing tenancy agreement, regardless of the provider.

63. In addition, there may have to be some minor changes to the Audit Commission's powers as the public sector auditor and inspector of local government, to ensure that there is broad equivalence with the private sector framework in ensuring service standards while reflecting the very different governance and financial systems.

Institutional arrangements

64. We are of the strong view that any decisions about institutional arrangements should flow from the definition of the principles and then the desired structure of the new system.

65. Based on our proposals, we consider that the regulatory body should have the following characteristics:

- able to promote a strong consumer ethos, with a focus on promoting resident opportunity, choice and value through the regulatory system
- a culture that is attuned and empathetic to regulating private sector organisations with a Board and Executive that understand and can respond to the financial and governance context in which private providers are operating
- a dedicated and expert focus on housing and related issues, with a lean professional team combining relevant professional skills - economic, consumer services, financial and supervisory
- an operational emphasis on seeking assurance on frameworks and processes, with a move away from direct provider engagement as the norm
- a positive, enabling culture that promotes provider development and diversification, commensurate with sustainable use of assets and resources
- the expertise and intent to enhance the interface between the regulatory framework and public investment in social housing - both capital and revenue.

66. We consider that such a regulator could be created either alongside the capital investment function as part of Communities England or as a stand-alone specialist social housing regulator.

67. Historically, there have been some very significant advantages of co-locating investment and regulation within the same body:

- it has facilitated policy passporting: it has promoted voluntary assimilation of Government policies through the wish to retain preferred investment partner status and the ability to bear the cost of those requirements across the whole of the asset base
- it has helped drive the use of financial capacity of regulated bodies: regulatory and investment roles in tandem have promoted balance between viability (which affects the cost of borrowing) and use of capacity (which influences the level of borrowing and grant rate)
- it has helped avoid duplication and conflict between investment and regulatory functions
- the investment function has been used on occasion to help solve regulatory problems and thus safeguard taxpayer and tenant interests
- it has enabled low transaction costs in the investment management system.

68. At the same time we can recognise potential weaknesses in the argument for continuing co-location:

- the Corporation's investment programme is now routed through only 84 lead partner organisations, (albeit that they are leading consortia that contain over 250 registered organisations)
- our recent study of RSL capacity suggests that the regulatory system has only had limited influence in driving efficiency in the use of assets for new supply and, at times, a conservative approach to the question of financial viability may have even restricted the optimum use of capacity
- there have been times in the Corporation's history when the relationship with the regulated sector has arguably become too comfortable, with regulation acting as a weak surrogate for the benchmark and driver of proper open competition for resources.

69. The question is whether these limitations of co-location can be addressed by the reform of the registration system or whether it also merits separation of functions.

70. In considering this question, it is also important to consider the role of Communities England itself. The more that Communities England is concerned with the long term sustainability of communities, as opposed to just the initial capital investment, then the stronger the case for co-locating the regulatory function. Indeed, that is the conclusion that was reached north of the border in creating Communities Scotland. It is also worth keeping in mind that the Government has already committed to transfer the Decent Homes programme and PFI to the new Agency, both of which embed a long term interest in the stock. Finally, there is an outstanding question whether, post-CSR, some neighbourhood renewal functions will transfer to the Agency. If this was to occur, it would increase the interest of Communities England in long term stewardship of neighbourhoods and would again increase the case for co-location.

71. On balance we consider that there is a strong case for continuing co-location of the investment and regulatory functions. While we can envisage how a separated system could also work, we believe that the burden of proof is firmly on those who would argue for the separation of functions to demonstrate that the resulting benefits would be greater than those that have been achieved historically from co-location.

Managing the Transition

72. There will be risk associated with any transition to a new regulatory system and structure. The level of risk will vary according to the model and structures adopted. However, under any model, there will be a number of risks:

- maintaining regulatory discipline: any change to the regulatory regime and regulator may put at risk the delivery of key regulatory objectives during the transition process. It will be important to ensure that the transition arrangements minimise the potential for any "authority vacuum" ahead of and during the process
- managing the legacy: the importance of building a new system that allows importation of existing partnership

development agreements, existing supervisory cases, oversight of the existing asset base etc.; this includes building in the ability to twin-track the old and new systems as necessary for a period of time

- maintaining stakeholder confidence : particularly, from lenders.

73. These risks need to be considered as part of the review process because they will become relevant from the point that recommendations are made.

Conclusion

74. The Housing Corporation wants to see fundamental reform of the regulatory system for affordable housing. It is unusual to be arguing for overhaul of a system that has been highly successful in its objectives and continues to serve the public interest well. But we can exercise sufficient foresight to know that the current system will not be 'fit for purpose' going forward and so we should prepare for change now.

75. There are elements of the current framework that we believe should be carried forward, particularly the cornerstone of a statutory registration system. But our overall vision is of a very different regulatory system to that which has gone before, a system built on twin pillars of customer accountability and value for the taxpayer and with a wide gateway that allows many types of private organisation to partner the State in responding to the fundamental challenge of meeting housing need and building strong communities.

ANNEX

Indicative Features of a Reformed System under Different Models

	Modernised Approach	Contract/licensed approach	Self-regulation
Statute	Essentially amended version of existing statutory provisions, extended by secondary legislation or statutory guidance	New primary legislation	New primary legislation
Powers	Would need to include new remit to drive efficiency.	Strategic powers to 'commission' provision of affordable housing services	Basic statutory framework to enable intervention against failure of industry to adequately enforce own codes
Scope	Maximise flexibility of registration within limitations of existing legislation, and better interface for non-registered providers	Contract-style licensing, with customer-supplier approach	Probably basic registration system to define who self-regulation applied to; this might be by reference to membership of recognised body
Standards	Revised Regulatory Code, with clearer penalties for non-compliance	Negotiated and then embedded in licence or contract; limited scope for change	Codes of practice for regulated activities, agreed by providers with other stakeholders
Transaction Costs	Lower costs to providers and State if further deregulation	Higher costs to State, higher to providers, at least during set-up phase	Lower costs to State, potentially higher to providers
Consumer Involvement	Embed consumer choice and influence through statutory guidance	Expectations negotiated and embedded in licence or contract	Framework defined by the providers to satisfaction of State.
Financial Management	Revised, simplified analysis procedures with greater role for provider auditors	Reporting requirements negotiated and embedded in licence or contract. In case of failure, loss of licence or enforcement of contract	Increased role for provider auditors, driving reporting standards
Diverse Activities	Weighting within risk model	No oversight of non-core activities outside scope of commissioned services	Subject to scope of self-regulation as agreed by providers and Government

Relative Assessment of the Strengths and Weaknesses of the Models

	Modernised Approach	Contract/Licensed Approach	Self-regulation
Supply	Depends on scope to amend statutory provisions to address current limitations on driving efficiency	New supply expectations would need to be embedded in contract or licence. Otherwise may leverage some additional homes just through pricing mechanism but no guarantee capacity would be expended on new supply	No real focus on generating new supply unless separate economic powers for independent regulator
Devolution	Some, more than present	Substantial, interest in commissioned activities rather than organisational form	Substantial
Implementation & Costs	Rapid, low cost	Very high transaction costs, at least in initial period and in wanting renegotiation, but may be reflected in keener pricing of service provision	Control over transitional costs, generally lower costs to State in longer term
Transition	Minimal	Contract-based migration to new system - complex	Relatively straightforward for existing providers, subject to sector drawing up self-regulatory framework
Historic Grant	Continuing control on trading, limited influence on use	Legal protection if can solve problem of transition of public interest in existing assets to contract or licence system	Continuing influence provided there is strategic power of independent regulator to drive efficiency and maximise asset use
Social Policy Delivery	Continuing influence and flexibility, but continued provider concern over inability to	Requirements can be embedded in initial contract or licence. Subsequently changing terms	Fluid, within modernised relationship between Government and providers.

	Modernised Approach	Contract/Licensed Approach	Self-regulation
	price. Also, limits of relying on voluntary assimilation	difficult - more difficult under contract than statutory licence	Depends on extent of Government ability to direct self-regulating sector to absorb new policy requirements within their framework
Consumer Outcomes	Weak drivers to improvement; lack of new intervention powers; short terms gains may not translate to long term performance; uneven outcomes	Embedded in contract or licence; therefore have to be measurable outputs rather than qualitative outcomes	Embedded within provider-led code. Therefore some loss of control over standard setting and reporting; acceptance of some uneven outcomes
Stability	No less than present	Investor confidence likely to be maintained provided there is clear step-in rights within the licence or contract. Lenders will tend to prefer statutory to contractual rights, and therefore statutory licence likely to be preferred over contract.	Investor confidence will be lower, leading to increase in pricing, unless clear statutory rights of intervention by the State are retained, in which case it's not full self-regulation.
Sector Risk	Weak drivers to innovation	Risk transfer to providers, creating new risks for regulator; unclear external drivers to innovation	Some loss of control over risk taking by providers
Rewards & Sanctions	Some wider, more formal scope	Managed through contract approaches. Danger of time delays on enforcement of contracts through the courts. With licence, probably won't have an incremental range of responses; therefore have to deal with cliff edge of loss of licence to operate	Could be effective, but only if self-regulation is embedded within a statutory framework of regulatory intervention by the State, in which case it's not full self-regulation.

	Modernised Approach	Contract/Licensed Approach	Self-regulation
Rent Pricing	Blunt tool of rent convergence operated by Ministers unless agreement to statutory devolution to regulator	Set through licence or contract, presumably with periodic review mechanisms	Would have to operate outside self-regulation, either by giving Ministers or separate economic regulator limited role on pricing and efficiency
New Markets	Limited incentives under current limited registration model	Depends on desirability of licence or contract terms. May be insufficient interest among new providers, if system is perceived as complex or too tailored to existing players	High incentives provided self-regulatory framework does not end up erecting deliberate barriers to entry
Smaller Providers	No more engagement than present	Subjects to terms of licence or contract	Tailored approach by providers
Presentation	Builds on the Elton Review, largely uncontentious, but limited in impact	Significant step beyond Elton Review, but will be contentious, particularly in terms of concerns around transaction costs and absence of interest in governance issues	Will trigger sharp concern from investors and resident representatives unless it is backed up by statutory framework and sharp intervention powers for the residual State regulator