



Exploring the costs and benefits of regulatory compliance

Final report to the Housing Corporation

September 2005

EXECUTIVE SUMMARY

This report was commissioned by the Housing Corporation to explore the costs and benefits of the regulatory framework that it oversees and implements

- This report was commissioned by the Housing Corporation (HC) to explore how they could assemble information on the costs and benefits of the regulatory framework they oversee and implement in order to improve the regulatory regime.
- The main object was to develop a framework within which to examine the costs of regulation for both the HC and housing associations and the corresponding benefits for them and for residents and society more widely.
- The work was conducted in two phases. The first scoping phase set out options for how this project could be tackled and the second analytical phase started the process of analysis and, in some cases, quantification of the costs and benefits.
- It was recognised that this second phase would be an exploratory exercise, the outcome of which would be a report providing insights into the costs and benefits and how further work might be taken forward.
- While the main focus has been to develop methodologies, the analysis also permits some preliminary, illustrative, conclusions about costs and benefits.
- Throughout the work there was a recognition that many other institutions are involved in the social housing sector. This report focuses specifically on the regulatory activities of the Housing Corporation.

The cost-benefit analysis indicates positive net quantifiable benefits of HC regulation in the region of £175 million (in NPV terms over a five year cycle)

- A rigorous, but pragmatic, approach to the estimation of the costs and benefits of the HC's regulatory activities has been developed. It indicates net quantifiable benefits that are around £175 million in NPV terms over a five year period (depending on the assumptions made they could range from about £63 million to about £335 million).
- The approach focuses on the role of the HC's regulatory duties and compares the costs and benefits of the impact of those duties on associations. It does so by using data from a small sample of 15 associations, alongside interviews with other stakeholders (e.g. banks, CML, NHF) to build up a picture of how costs and benefits vary by:
 - association size: RASA, small, medium, large
 - risk of the association: low, medium, high
 - location of the association: across the regions
- The data also reveals that:
 - net quantifiable benefits increase with association size – larger associations, who tend to borrow more, see higher net benefits
 - total costs increase with association size and risk – large associations also face higher total costs of regulation, as do associations classified as higher risk
- The most costly HC regulatory measures tend to be: the RSR, Inspection Action Plans, BME Action Plans, HC engagements with the Board and External Validation of Performance Reporting Systems. A number of other items also impose similar levels of cost to these five (e.g. FV3, Tenant/resident survey, Complaints policy and procedure). The most costly items vary largely by the level of risk of the associations.
- It was not possible within the scope of the project to determine whether the most costly individual items were also those responsible for a number of important benefits. There are a number of other additional benefits that it was not possible to quantify. These include:
 - Tenant security: HC monitoring and intervention with landlords to protect the interests of tenants
 - Policy passporting: the ability of government, and parliament, to use the HC as a vehicle to quickly and effectively implement policies relating to the sector
 - Reassurance: current rules require local authority transfers to go to registered social landlords, potentially reflecting the reassurance this provides to tenants and parliament
 - Contagion: protection HC provides to well-performing associations by trying to ensure that poorly performing associations do not fail and performance issues are effectively remedied

Qualitative results support this analysis, and indicate potential future paths down which the HC's regulatory framework could develop

- Qualitative feedback from associations indicated that the regulatory framework has improved considerably over the past 3-4 years. However, it was generally felt that changes in the following areas could be made without affecting the desirable outcomes:
 - Financial monitoring: greater transparency in the use of financial indicators, and potentially decreased reporting requirements where the HC makes limited use of the indicators
 - Risk based regulation: as part of the current roll-out of more risk based regulation, it will be important to monitor whether the extent of the variation in regulatory burden itself could be greater across risk types
 - Regulatory processes: greater certainty over definitions and requirements in documents submitted regularly (e.g. definitions in the RSR), faster publication of results and more transparency in how decisions are made (e.g. about risk categorisation)
- The qualitative feedback also indicates that the regulatory framework itself has a relatively small impact on the cost of borrowing – with competition between lenders and the low risk of the sector due to the benefits regime likely to be equally, if not more, important. However, the impact is clear and, because of the large scale of borrowing, has an important impact on cost savings for the sector.
- Over the course of this study a number of government publications have suggested how best to minimise the burden of regulation, including the Hampton Review about reducing regulatory burdens and the Better Regulation Task Force publication about how to assess the cost of regulation. This study incorporates the findings of these reports and takes their recommended approaches into account.
- Combining the results of this study with some of the messages from these publications indicates a number of areas where the HC could investigate whether changes would benefit the sector:
 - an expanded survey would help to test the robustness of the findings in this report, which is based on a small number of interviews
 - more work on the costs of specific regulatory requirements (ie individual documents), and linking those to specific benefits
 - further work on the degree to which the monitoring duties of HC affect lending rates, reasoning of credit committees and impact of a more pronounced shift to risk-based regulation on lending to the sector
 - is there scope to differentiate reporting requirements to a greater extent across risk types while meeting HC's statutory obligations?
 - building a consensus on the additional benefits – what are they? Which government policies does the HC facilitate and how?
 - full response to Hampton, BRTF and other upcoming reports in light of HC's actions and plans

INTRODUCTION

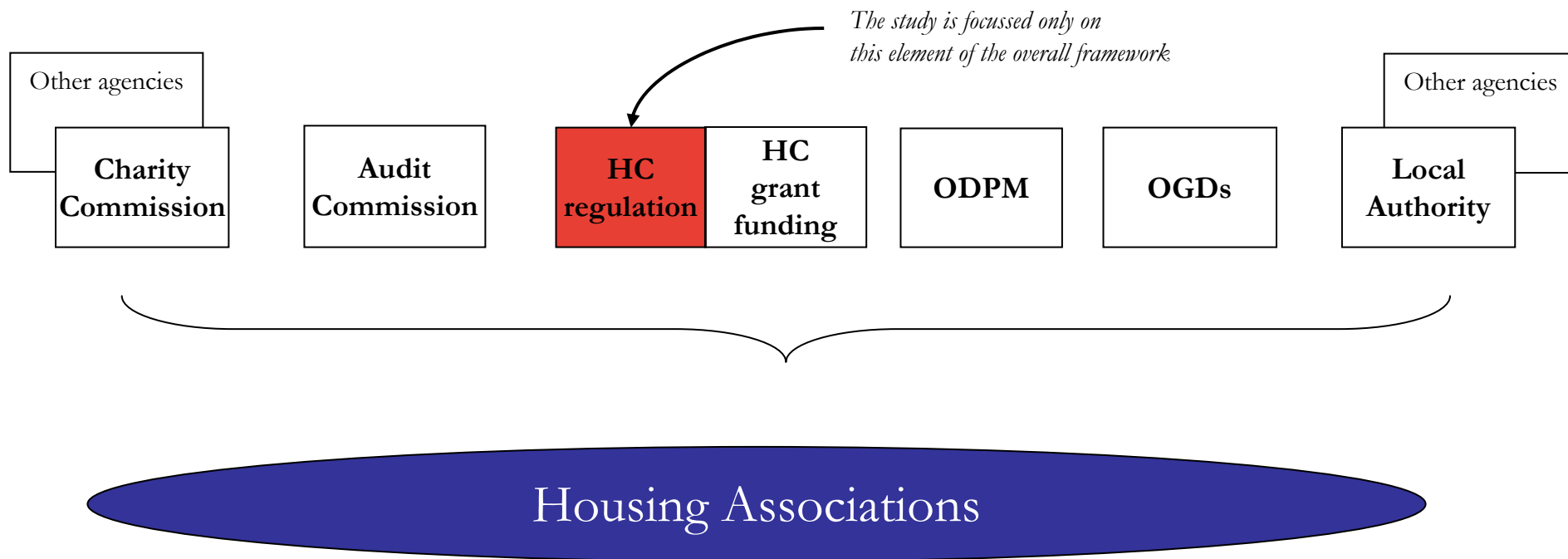
Frontier was appointed in December 2004 to investigate the costs and benefits of compliance with the Housing Corporation's regulatory framework – this report sets out the initial conclusions

- The supply of affordable housing is becoming an increasingly important economic and social issue. The Housing Corporation (*HC*) plays a central role in meeting the growing demand for well-built and maintained affordable housing in all areas of the country. It has clear objectives and it is critical that these are achieved in the most cost effective way. It is in this context, that the HC wishes to develop a reliable evidence base that illustrates the effectiveness of its regulatory framework in term of both costs and benefits.
- Frontier was appointed in December 2004 to investigate the costs and benefits of social housing regulation and to explore the impact of regulation on a number of housing associations.
- The main objective of this project is to develop a framework within which to examine the costs and benefits for both the HC and the housing associations (*associations*), residents and society more widely. Our central approach consists of:
 - developing a coherent framework within which to address the issue;
 - collecting data and evidence on the costs and benefits to illustrate the implementation of the framework; and
 - placing this analysis within a robust risk-based framework.
- At the kick-off meeting, it was decided to divide the project into two phases. The first, scoping phase set out our approach to the detailed, second, analytical phase. The analytical phase would put initial numbers on key elements of the costs and benefits, insofar as that was possible within the scope of the study. This might in turn lead to further work to refine the overall analysis or particular parts of it . This report presents the results from that second phase.
- The report provides evidence based on interviews and data collection undertaken between January and May 2005. Consequently, it provides only a snapshot of views at this time. It does not provide evidence about how those views are evolving or whether they would change in light of on-going activities by the Housing Corporation and others to adjust the approach to regulation in the sector.

A framework and proposals for calculating the costs and benefits of HC regulation has been developed based on current best practice

- Frontier has developed an approach for calculating the costs and benefits of HC regulation. The analysis is based on the regulatory framework created by the HC as part of their ongoing monitoring activities.
- The HC has a statutory role in overseeing the governance, financial viability and management performance of associations. The powers of the HC are laid down in the Housing Associations Act (1985) and the Housing Acts (1988) and (1996). The HC is also the primary source of grant funding for the provision of affordable housing for rent or sale.
- The time and resources available for the project prevented a detailed survey of all associations. Consequently, the cost benefit analysis consisted of three key steps, outlined below:
 - **Estimating costs:** Establish the requirements of existing regulation then attach cost values to the requirements. Cost values were based on the time and wage-costs of fulfilling the requirements. They were calculated for a set of representative associations.
 - **Estimating benefits:** Establish whether there are specific benefits associated with the current regulatory regime that would be lost if the regulatory requirements were removed. Additionally, account for any wider benefits that may accrue (e.g. reassurance, allowing efficient policy pasporting).
 - **Aggregate cost-benefit analysis:** Calculate aggregate cost/benefit for the sector (as well as representative associations) that allowed initial conclusions to be drawn about the administrative impact of the regulatory framework.

The framework is limited to the regulatory functions of the HC, it does not consider the many other organisations and other parts of the HC responsible for delivering the government's objectives in social housing.



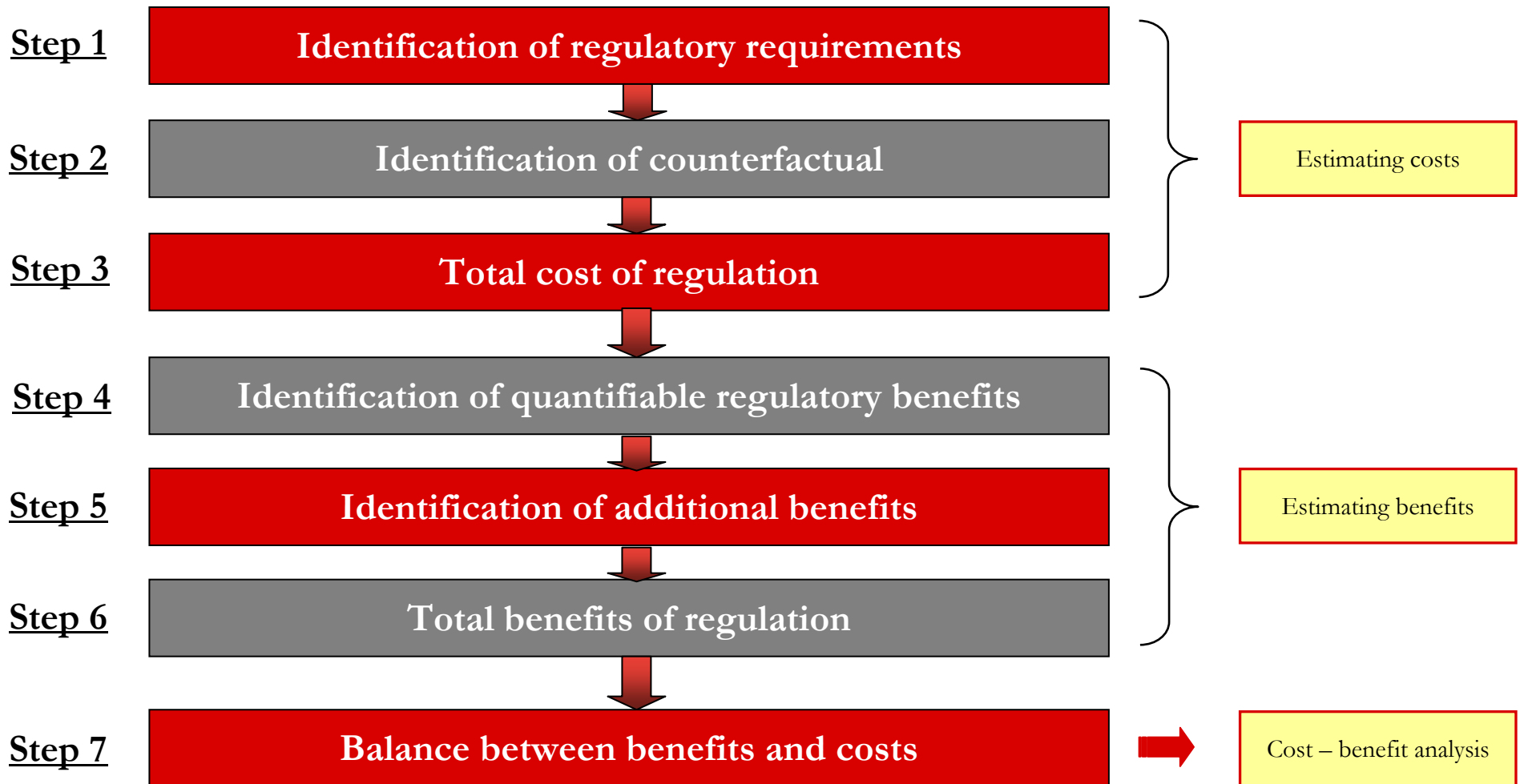
- The analysis is focussed on one element within the wider institutional setting. However, viewed in light of recent reports about the burden of regulation (e.g. the Hampton Report “Reducing Administrative Burdens”; Better Regulation Task Force “Less is More”), the focus of this analysis is on issues of central importance to government and how regulation is carried forward.

The purpose of our study was to provide a robust framework for considering the costs and benefits of the regulatory framework and to illustrate how that framework can be applied

- The purpose of our study was to develop a robust framework and methodology for considering the costs and benefits of the HC's regulatory regime.
- This study is not an attempt to provide a rigorous quantification of all the costs and benefits of the existing regulatory framework. Rather, our work provides an illustration of how the framework we have developed can be applied in order to estimate the costs and benefits of regulation.
- In illustrating the framework, the study does provide estimates of the costs and benefits associated with the regulatory regime. These estimates are based on the best currently available evidence and have been produced in a manner consistent with the framework we have developed. However, there are a number of caveats:
 - The sample size is small. While care was taken to ensure that the associations we met with were 'representative', it would be necessary to undertake a wider survey in order for the cost and benefit estimates to be statistically robust.
 - There is considerable uncertainty attached to our estimate of aggregate level net benefit estimates. Partly due to the small sample size discussed above – and partly due to methodological issues concerning the estimation of costs and benefits – we have reported a relatively wide range for aggregate level net benefits. An expanded sample size and further consideration of the specific estimation methodologies could allow more precise estimates.
 - Quantification of additional costs / benefits. Only one benefit has lent itself to quantification in this relatively brief exercise. There are a number of benefits (and to a lesser extent, costs) that have not been quantified for the purpose of this study. Therefore, on balance, it is likely that net benefits are higher than reported here. Further work might allow exploration of the as-yet-unquantified benefits, and indeed some costs, to be included in the analysis
- The issues highlighted above means that care must be taken when reviewing the quantifiable cost and benefit estimates reported in this study. At an aggregate level, the upper and lower ranges for net benefits reflect the degree of uncertainty we think is prudent.
- Nonetheless, our results do represent an illustration of how our methodological framework can be applied in order to think about costs and benefits. Additionally, the results do provide a useful indication of how both costs and benefits are likely to vary across the different types of housing association. Cost quantification has gone further than benefit quantification and, as such, should provide a useful way in to implementing an approach to the recommendations of the recent BRTF report.

The framework has seven steps, which were described in detail in the *Scoping Report*

- The framework we propose consists of seven steps, which are outlined in more detail later - a summary is presented below. These steps outline the process we intend to go through in estimating the costs and benefits of the current regulatory regime.



APPROACH

A pragmatic approach was developed that combined qualitative and quantitative information, in line with recommendations in the Green Book and from the BRTF

- Frontier set out our proposed approach for this work in the *Scoping Report*. The approach we have taken is a pragmatic one, that recognises the constraints of such analysis. Where appropriate it incorporates recent publications from the Better Regulation Task Force (e.g “Less is More”), the Hampton Review and HM Treasury’s Green Book.
- It was beyond the scope of the work agreed with the HC for us to undertake a full cost-benefit survey of all housing associations. The next best approach was adopted: estimate costs and benefits for individual representative associations and then use these estimates to calculate overall costs and benefits.
- This approach is necessarily reliant on information sourced from a relatively small number of representative associations. Nine associations completed the full data request. A further ten were consulted and provided qualitative comments and analysis. Some sensitivity analysis is provided. However, a larger survey is required to fully assess the robustness of the results.
- The associations that were surveyed covered the full range of:
 - sizes: from RASA through medium to large associations
 - risk levels: low, medium and high risk
 - geography: located throughout England, including London, Liverpool, Birmingham, York and rural areas.
- The approach we have adopted will allow us to answer the following questions:
 - **Question 1:** do the current benefits outweigh the current costs of regulation, given the agreed counterfactual?
 - **Question 2:** if yes (to question 1), could the same objectives be met at a lower cost?
 - **Question 3:** if no (to question 1), what changes are required to ensure benefits do outweigh costs?

Our approach involves the definition of a counterfactual that is used to estimate which costs and benefits are additional to those that would exist in any event

○ The approach required:

- **Definition of the counterfactual.** A counterfactual is required to assess which costs imposed by the HC are additional to those that would exist in any event. The chosen counterfactual assumes the HC's duties would be limited to actions related to the development grant process and rent restructuring, while other regulatory and inspection agencies (e.g. Audit Commission, Charity Commission) continue unchanged.
- **Estimate costs.** In order to estimate the costs of the regulatory framework, we adapted the Standard Cost Model, which consists of multiplying hourly wage rates for associations by an estimate of the time it takes them to comply with regulatory items. This approach required us to obtain information on both wage rates and time taken to comply with regulation. The Standard Cost Model approach is considered by the Better Regulation Task Force to constitute best practice – see the panel at the bottom of the page for details.
- **Estimate benefits.** Benefits are separated into those that are quantifiable and non quantifiable. The quantifiable benefits are the lower borrowing rates achieved by associations compared to what they would receive under the counterfactual. The non quantifiable benefits include the wider impact of HC on tenants and the ability of government to deliver on its commitments in social housing. The BRTF approach could be adapted to further quantify some benefits.
- **Consideration of how costs and benefits vary.** We considered that costs and benefits might vary depending on an association's location, size and riskiness. For example, on average we would expect an association in London to pay higher wages than an association located somewhere else. We obtained information on how the key input parameters varied across the three dimensions outlined.

Estimating the costs of regulation

- Our cost calculations are based on adapting the latest publicly available best practice guidance. This was set out in *Less is more: reducing burdens, improving outcomes*, published by The Better Regulation Taskforce (March 2005). Some key extracts from this guidance are set out below.

The mechanics of the standard cost model (see Annex B for more detail)

- *“Each information obligation associated with every regulation is separately identified. The regulatory burden imposed by each information obligation... is then estimated as: $N * W * T$ where*

N = number of businesses affected by obligation

W = the hourly tariff of those involved in meeting the obligation

T = The number of hours taken to meet the administrative obligation in a year

- *The standard cost model provides a stylised estimate of the administrative burden. It does not pretend to measure the true administrative burden. Rather, it produces a standardised set of numbers which when aggregated together gives... an overall picture of regulation, thereby enabling it to identify actions that will reduce the burden.”*

The approach focuses on the regulatory activities of the HC

- The analysis was concentrated on those activities which were clearly part of the HC's mainstream regulation.
- To understand the implications of regulation and its costs and benefits it is necessary to establish a counterfactual that covers the tasks an association would still have to do if there were no regulatory regime – to comply with the law and good business practice.
- The Corporation established a Sounding Board to provide feedback as the analysis progressed. The first meeting was at the end of the first phase where we discussed with them the scope of the study.
- It was subsequently agreed with the HC that this exercise should concentrate on requirements specifically for regulation and should not focus on information required by the Corporation to support its grant-giving function.
- The issue of policy passporting was also considered (discussed in more detail on slide 24). The Corporation frequently assists the Government in delivering new policy. This is not strictly part of the regulatory regime, but the use of that regime facilitates the delivery of some policies.
- It was agreed that a cost benefit analysis of this issue was beyond the scope of this project and, at the extreme, could result in having to quantify the benefits of wider-ranging Government policies.
- Therefore this project concentrates on pure regulation, conscious that this would not cover a number of costs incurred by associations. This is discussed in more detail in later sections.

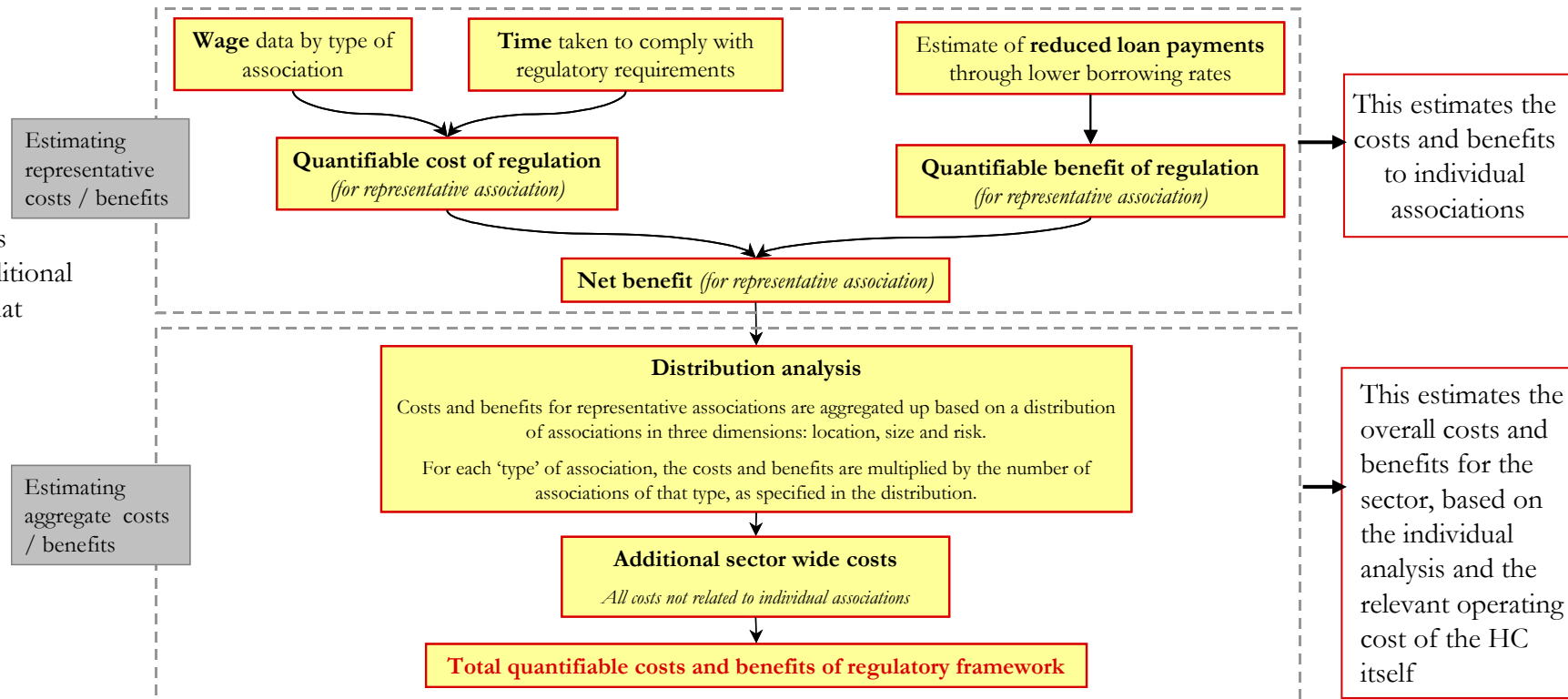
Information was collected through a series of interviews and data collection exercises with a small number of associations, lenders and other stakeholders (e.g. CML, NHF)

- In order to understand how the regulatory framework impacts housing associations in terms of both costs and benefits, Frontier met with 15 associations.
- The costs and benefits incurred by an association vary depending on that association's location, size and risk. Given this, Frontier ensured that the range of associations we met with included associations of various locations, size and risk levels.
- During these meetings, Frontier canvassed the associations for their views on the costs and benefits arising from the existing regulatory framework of the HC.
- Frontier asked all of the associations we met with to provide data on how long it took them (per year) to comply with the regulatory framework of the HC. For this purpose, each association was provided with a standard Excel template (whose scope and content was agreed with the HC, associations and others, see Annex F) in which they could indicate, for a list of regulatory items outlined:
 - how much time they spent complying per year; and
 - how that time was split between chief executives, senior managers, middle managers and junior managers.
- The numbers received from associations were discussed but not formally audited, they were accepted as good approximations of the actual time spent.
- Frontier also met with three of the major lenders to the social housing sector. During these meetings, we discussed, in general terms, lending practices in the housing sector. We also specifically considered the extent to which the existing regulatory framework impacts on lending practices to housing associations.
- Further meetings were held with other stakeholders, including the Council for Mortgage Lenders and the National Housing Federation. In these meetings, Frontier discussed the approach being employed in our study and discussed, in some detail, the stakeholders' views on the existing regulatory framework.
- Frontier also received data from the HC themselves. The information provided by the HC included:
 - association wages rates;
 - data on borrowing by associations – including loans outstanding and interest rates;
 - an apportionment of HC operating costs that relate directly to regulation; and
 - distribution of associations by risk, location and size.
- Full details of this, along with details of all the inputs used in our analysis can be found in Annex A.

A cost-benefit analysis model was developed, which employed the data and information collected to provide an illustrative cost-benefit analysis

- In order to estimate the costs and benefits of the HC’s regulatory framework, Frontier developed a cost-benefit analysis model. Based on a range of inputs relating to specific cost items and benefits, the model generates central, lower and upper estimates for the net benefit of the HC’s regulatory framework.
- The model has two main functions, which are:
 - a calculation of detailed cost and benefit estimates for individual ‘representative’ housing associations; and
 - an aggregation of individual level estimates for representative associations to estimate total costs and benefits of the regulatory framework.
- The following diagram provides an illustration of the model’s structure. Further details of the model’s functionality and inputs used for the calculations can be found in Annex A.

Note: To the model’s outputs are added additional benefits (and costs) that cannot be quantified.



Our approach includes running sensitivities around areas of uncertainty – such as the perceived benefit of lower borrowing rates

- A key element of best practice is sensitivity analysis around areas of uncertainty. This consists of reporting upper and lower ranges for cost / benefit estimates and also conducting ‘what if’ scenarios around key parameters. Our results (outlined later) provide an indication of how sensitive our findings are to changes in the underlying assumptions.
- An important area around which we have run sensitivities is the extent to which associations are able to borrow at lower rates as a result of the regulatory framework. Both lenders and associations were asked their views about the degree to which the monitoring function of the HC contributed to rates that were lower than would otherwise be the case.
- This issue is particularly important to any cost-benefit analysis of the sector due because associations borrow large sums of money in order to invest in housing stock. Given the large sums of borrowing observed in the sector, the potential benefit of any reduction in interest rates is substantial. Therefore, it is important to understand the extent to which this perceived benefit is genuinely associated with the regulatory framework.
- From our meetings with associations, lenders and other stakeholders (discussed later) it became clear that there are a number of factors which influence the rates at which associations are able to borrow. These include competition among lenders to provide funds, stability of cashflows created by the housing benefit regime and the HC itself.
- Our approach explicitly takes this into account by reporting the potential benefit of the HC’s regulatory regime alone based on central (35 basis points), upper (50 basis points) and lower (25 basis points) estimates of the interest rate discount achieved by associations. These rates were based on the estimates provided by lenders to the sector during our interviews with them.
- In presenting our final results, we clearly set out central, upper and lower estimates for both costs and benefits. With regard to borrowing rates, we also provide an overview of the sensitivity of the results to the proportion of benefit assigned to the HC.
- Given the exploratory nature of this exercise not all costs and benefits were quantified. We have provided a list of additional costs and benefits that it was not possible to quantify within the scope of this project. A number of these benefits are important in policy terms (e.g. reinsurance provided by RSL status, policy passporting).

The model calculates the costs and benefits over a five year period, using a discount rate of 3.5%

- A number of the requirements on associations do not occur on an annual basis – some documents need only be completed once every two or three years.
- Consequently, it was decided to calculate both costs and benefits over a five year period in order to capture the full set of costs and benefits of regulation.
- Aggregate costs and benefits were then brought to a single year by taking the present value of the costs and benefits.
- A discount rate of 3.5% per year was used to calculate the present values, this is the rate recommended in the HM Treasury Green Book (*“Appraisal and Evaluation in Central Government”*).

BENEFITS

Our study includes both quantifiable and non quantifiable benefits

- The main quantifiable benefits considered in this study are the lower interest rates at which associations are able to borrow. However, a number of further benefits considered in this study have not been quantified, either because:
 - it is conceptually difficult to quantify the benefits for some items; or
 - the scope and timeframe of the study has not allowed us to quantify the benefit.
- The fact that some potential benefits have not been quantified does not imply that they are not significant. This study seeks to explicitly consider both the quantifiable and non quantifiable benefits of the HC's regulatory framework.
- When reviewing the quantifiable net benefit results presented in the subsequent slides, the impact of non quantifiable benefits should be kept in mind. For example, some non quantifiable benefits could be particularly important and, were they to be quantified, would increase the net benefit results reported in this study.
- Our information on potential benefits was obtained through a series of meetings, held with a range of housing associations, lenders and other stakeholders. These meetings were held in order to canvass their views about the costs and benefits of the HC's regulatory framework.
- Based on these meetings, we suggest that a number of benefits may arise from the regulatory framework. Of these benefits, our study provides a quantitative assessment of the benefit associated with lower borrowing rates. A discussion of the further benefits we have identified is shown on the following slides.

Our findings suggest there are a number of important non quantifiable benefits associated with the regulatory framework

- In the following slides, we provide a brief summary of the unquantified benefits, including a suggestion about how the benefit could be quantified and the likely level of the importance of the benefit.
- **Direct benefits to tenants:** there may be a range of potential benefits associated with being a tenant of a regulated housing organisation, as opposed to other public or private subsidised housing. For example, tenants may indirectly benefit from the HC's role in ensuring that the decent homes standard is met, they also benefit from the HC's role in protecting their interests.
- Tenants may also benefit from the security provided by the RSL framework in the event that their landlord gets into financial difficulty and from the prospect that a poor-performing landlord will be held to account through the regulatory regime.
- For indirect benefits to tenants, it may be possible to use a measure of tenant's '*willingness to pay*' as a means of quantifying the benefits. For example, a sample of tenants could be surveyed and asked how much they value particular outcomes of the existing regulatory framework. In relation to the decent homes standard for example, tenants could be asked by how much they would expect their rent to be reduced in the event that the decent homes standard was no longer enforced. However, this approach is difficult to implement amongst low income households who often find it difficult to assign hypothetical values to outcomes that, in practice, they could not afford because of their income level.
- Benefits to tenants, especially as they relate to the role of the HC in protecting their interests, are amongst the most significant of those benefits not quantified in the current study.
- **Reassurance:** current rules require local authority transfers to go to registered social landlords, potentially reflecting the reassurance this provides to tenants and parliament.
- To quantify the benefit relating to reassurance, it would be necessary to consider how much that reassurance would cost under an alternative regime. For example, if transfers did not have to go to RSLs, parliament may wish to have administrative procedures in place to ensure that transfers were completed in an acceptable manner and to reliable landlords. A number of associations set up to receive voluntary transfers have spent time in supervision. This lends support to the notion that RSL status provides reassurance to tenants and other stakeholders.
- It is possible that the administrative costs necessary to achieve reassurance could be large. However, it is difficult to quantify the likely importance of this particular benefit.

Further non quantifiable benefits associated with the regulatory framework include facilitating policy implementation

- **Policy passporting:** the existing regulatory framework effectively allows government to use the HC as a vehicle to implement some housing policies. For example Under section 12 of the Anti Social Behaviour Act (2003) all housing associations must produce an anti social behaviour policy (ASBP). The HC itself has a role in ensuring and assessing compliance with this requirement. This '*policy passporting*' may yield a benefit if alternative mechanisms for policy implementation were more costly.
- A full cost benefit analysis would look at the cost implications of a particular mechanism and the wider policy benefits. This would be a major and potentially open-ended task. An alternative would be to:
 - identify specific HC activities which are the direct result of passporting;
 - identify an alternative mechanism that Government might use in the absence of the HC; and
 - compare the costs of the two activities (probably on a cost of time basis i.e. estimating the number of man hours required to implement policy through the two alternative channels)
- Having done this, it would be possible to ascertain whether the costs of passporting were lower than the costs of the alternative implementation mechanism. Any cost savings attributable to passporting effectively represent the quantifiable benefits.
- A number of HC activities relate to passporting and several have been significant in recent years – rent restructuring, decent homes and promoting efficiency. Given that the Housing Corporation has developed substantial experience working with associations in implementing Government policy, and has established an effective level of goodwill with associations on these issues, it is unlikely that any alternative arrangements would be more effective.
- **Preventing contagion:** the regulatory framework may contribute to the overall stability of the sector. If the failure of poorly performing associations has an impact on those that perform well, then the HC affords well-performing associations a level of protection that might not otherwise exist.
- To a degree, the benefits associated with preventing contagion are included in the present analysis, in the form of potential interest rate savings to housing associations. However, there may be further, private benefits to well-performing associations that arise as a result of knowing that the sector is secure. A range of processes and activities undertaken by these associations might be different in the absence of this security and this in itself, might yield some benefit.
- Given that most important element of this benefit can – and has been – quantified through the estimation of interest rate savings, any additional benefit relating to the prevention of contagion is likely to be small.

Further non quantifiable benefits associated with the regulatory framework

- **Best practice:** the HC plays an important role in the coordination and dissemination of best practice across associations. For example, in doing so, it may be the case that standards of governance are higher than would be the case in the absence of the regulatory framework.
- Quantifying the potential benefits that arise from disseminating best practice guidelines is not straightforward. For example, actually identifying any measurable impact that such guidance has is likely to be extremely difficult. Given this, a willingness to pay methodology could be employed. For example, associations could be surveyed in order to assess how much they would be prepared to pay for best practice advice, in the absence of the materials already supplied by the HC. Alternatively, proxies could be used to estimate the potential benefits of providing such guidance (e.g. training packages offered by the private sector).
- **Benchmarking:** a number of housing associations suggested that the existing regulatory framework facilitates benchmarking, which would otherwise be undertaken at the expense of the associations themselves.
- It may be possible to quantify the benefits arising from benchmarking by examining benchmarking costs in other sectors. For example, it might be possible to estimate to costs of benchmarking in the private housing sector.
- The beneficiaries will be the housing associations themselves, although some associations are likely to accrue a higher benefit than others.

Evidence from associations and lenders suggests that lower borrowing rates are a quantifiable benefit of the regulatory framework

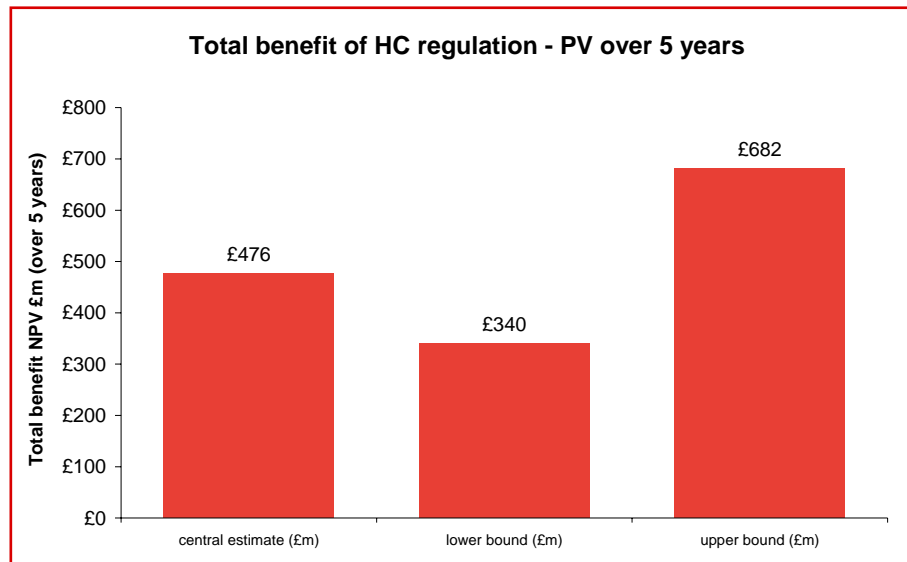
- **Evidence from meetings with associations:** The associations we met with all referred to the lower rates of borrowing (compared to the commercial sector) available to them as a benefit of the regulatory framework. However, there was some variation in opinion about the extent to which this benefit is attributable to regulation itself. Additionally, most associations felt that the fundamentals of the sector would not be affected by scaling down the regulatory role of the HC.
- **Evidence from meetings with lenders:** The lenders all agreed that the existence of the HC's regulatory regime had an impact on lending practices. It contributes to the perception of social housing as a low risk sector, especially amongst credit committees who are responsible for setting wider lending strategy.
- All lenders mentioned that the existence of the HC and its associated regulatory framework provided comfort to their credit committees. This allowed them to make funds available to the sector at relatively low rates.
- The lenders did add that some of the HC's functions were more valuable than others. For example, all the lenders commented that they independently assessed the financial viability and risk of the associations. Conversely the lenders suggested that banks have very limited mechanisms for monitoring governance and management themselves, making this function of the HC more valuable from their perspective.
- The lenders all commented that there was considerable competition amongst lenders and that this had helped to keep interest rates down for housing associations, independently of any HC activity.
- When discussing the role of credit ratings, the lenders suggested that the credit rating agencies largely replicated the bank's own internal risk assessments of associations. They all agreed that credit rating agency scores had little or no influence on either their decision to lend to associations or on the interest rates offered to associations. However, the lenders did suggest that credit ratings were sometimes a helpful validation of their own analysis.

Discussions indicate a range of 30 to 35 basis point savings attributable to the regulatory framework.

- Alongside the role of the HC in keeping lending rates low, the lenders also suggested that there were a number of other factors that contributed to the lower borrowing rates available to associations:
 - the underlying nature of the sector being low risk (e.g. housing benefit underwrites revenues, lack of failures in the sector etc); and
 - competition amongst lenders.
- We discussed lending rates (i.e. risk premia) with each of the lenders. As part of that discussion we asked them to estimate the impact on rates of the counterfactual world in which the HC did not exist.
- Lenders all agreed that rates would be higher under this counterfactual. They focussed on a range of about 30 to 35 basis points (i.e. 0.30 to 0.35%) increase in rates under the counterfactual.
- This range was thought to represent the additional value of the regulatory framework as overseen and implemented by the HC. It is the basis for the quantitative estimate of benefits.

Our analysis indicates that aggregate level benefits are large...

- The quantifiable benefits considered in this study are the lower rates of interest available to housing associations as a result of the regulatory framework.
- Our analysis allows us to review:
 - aggregate level benefits to the sector as a whole; and
 - how this benefit varies by type of representative association.
- The aggregate level benefit to the sector as a whole is large. Our results indicate that benefits are between about £340m and £680m over five years, in PV terms – depending on the level of interest rate discount attributable to the regulatory framework.
- This result is driven by the fact that associations borrow large sums of money, so that any slight reduction in interest rates has a large impact on ongoing interest payments. For example, our analysis suggests that, for a large sized associations, a discount of 0.25% on interest rates could result in savings in the region of £360,000 per year in interest payments (though this depends on the amount of outstanding debt).
- As outlined previously, in addition to this quantifiable benefit, there are a number of important non quantifiable benefits which must be considered. Were it possible to quantify these additional benefits, the aggregate level benefit shown below would be higher.

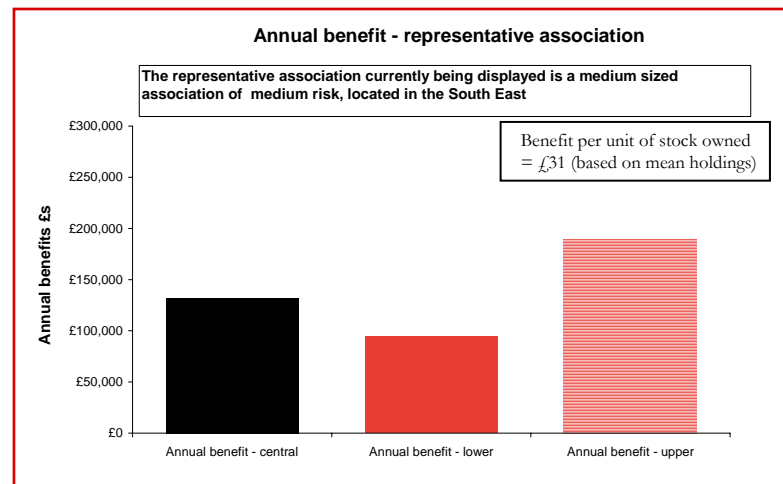
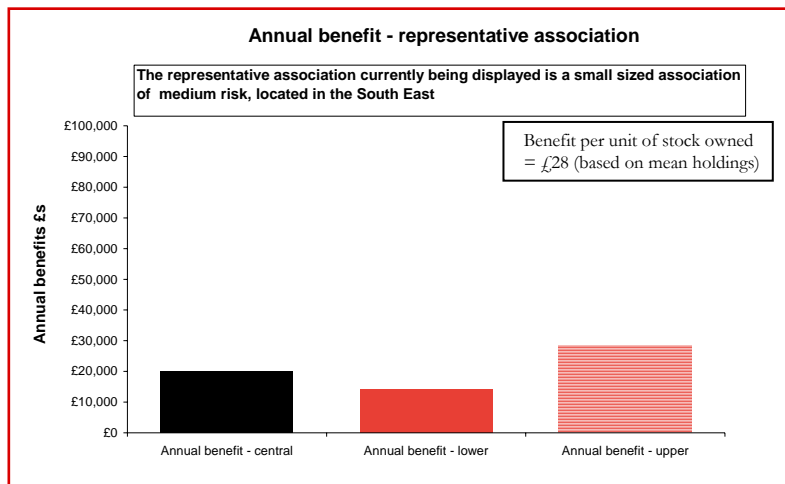


The aggregate level benefits shown are estimated from benefits calculated at the level of individual representative associations.

To calculate aggregate level benefits, individual association benefit figures (which are calculated in the cost benefit model) are multiplied up based on a distribution. For example, if we believe there are 10 associations of type A, the benefit calculated for type A association is multiplied by 10. For full details, see annex A.

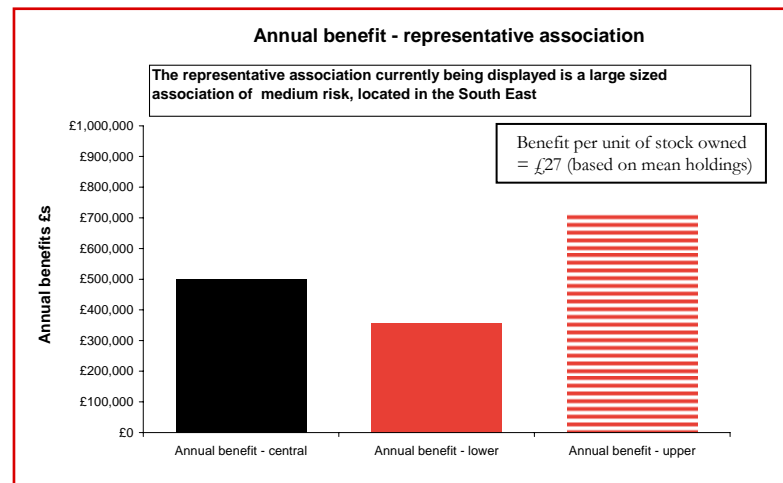
...and the level of benefit varies significantly across different types of associations

- Our analysis allowed us to review quantifiable benefits at the level of individual representative associations. Our results show that the level of benefit varies significantly across different types of associations.
- Variation in the level of quantifiable benefit is driven partly by the size of association. As larger associations tend to borrow more than smaller associations, they tend to benefit more from interest rate discounts.
- The following charts provide an illustration as to how the quantifiable benefit varies across the representative association types modelled in our study.¹



The charts provide an illustration of how benefit varies by type of association. In the examples shown, the large sized association achieves an ‘upper case’ benefit in excess of £700k pa, whereas the small sized association achieves a maximum benefit of £29k pa.

This is because large associations tend to borrow more than smaller associations and thus benefit more from interest rate discounts.



1: in these and subsequent figures, “risk” is based on the HC’s risk model which looks closely at the potential impact of the association.

COSTS

Interviews with associations provided an overview of the costs associated with the regulatory framework including those associated with financial reporting ...

- Our information on costs was obtained through a series of meetings, held with a range of housing associations, lenders and other stakeholders. These meetings were used to canvass their views about the costs and benefits of the HC's regulatory framework.
- From our meetings with associations, it was clear that there was a degree of variation in the views held, both in regard to the existing costs and benefits of the regulatory framework; but also relating to how the framework might be reformed.
- There was a consensus view amongst the associations that there have been large improvements in how the regulatory framework has been implemented over the last 3 – 4 years. Nonetheless, the meetings did allow us to identify, from the perspective of associations, the most significant regulatory costs and areas where further improvements would be regarded positively:
- **Financial requirements:** Most of the associations we met with identified the financial data requirements of the HC as an area in which more transparency may be required, and potentially the regulatory burden could be decreased. A number of associations suggested their internal financial processes (along with lender requirements) were sufficient to ensure viability (although the HC may need to monitor financial indicators for wider reasons). The key points raised in this regard were:
 - lenders impose discipline on associations because they independently assess risk, although it is important to recognise the HC may need to monitor a wider range of issues than lenders given its statutory duties
 - business plans and audited accounts (alongside internal checks) are sufficient in unregulated sectors
 - proper governance and management of associations, including appropriate skills on the board, will lead to effective financial monitoring
 - associations do not understand when and how the HC uses the financial data that it collects for monitoring purposes
- The comments on financial requirements do not take into account those who are not currently borrowing or those receiving grants through the partnering process. In both these cases the HC may be required to undertake financial due diligence.

...the risk based regulatory framework, lead regulation and governance

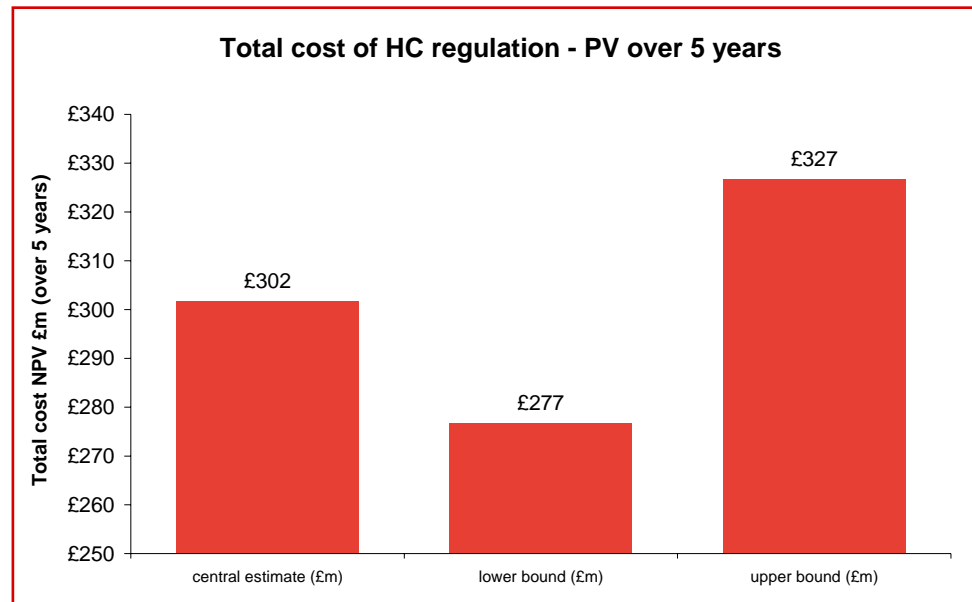
- **Risk based regulation:** The HC is in the process of rolling out its approach to risk-based regulation. It will be important to monitor whether changes that are only just being implemented affect the current view that the regulatory requirements do not vary sufficiently with the risk (and other characteristics) of associations.
- **Processes:** Some associations expressed the view that the processes of the HC could be improved in a way that would lessen the regulatory burden upon them. For example, in the case of the RSR and financial returns it was suggested that the HC often introduces late definition changes for variables, making data collection more costly to associations than is necessary. More generally, changes to processes and definitions were felt to be too frequent. Separately, processes should be faster if the full benefits of some regulatory instruments are to be realised. For example, issuing the compiled RSR data closer to real-time.
- **Lead regulation:** the structure and processes associated with lead regulators were generally viewed positively but the lead regulators change too frequently, requiring associations to spend time renewing relationships and bringing new people up to-date
- **Governance:** generally positive view of governance monitoring (although sometimes felt to be too intrusive) and its usefulness; as well as an appreciation for the changes in approach made by the HC over the past few years. There was a general feeling that had we been speaking to associations 3 to 4 years ago there would have been many more negative comments.

The majority of costs have been quantified in our analysis, though there are some additional non quantifiable costs, which may be important

- As outlined in our approach, we estimated the costs associated with the regulatory framework using the Standard Cost Model. This has allowed us to estimate the costs associated with each regulatory item included in our counterfactual. From this, we can build up a picture of the overall costs that are additional to the current regulatory framework. Details of our cost estimates are provided in the following slides.
- The numbers received from associations were discussed but not formally audited, they were accepted as good approximations of the actual time spent.
- In addition to this, there are a number of cost items, largely relating to the *process* of regulation, which are not quantified in our analysis. When reviewing the aggregate cost estimates shown on subsequent slides therefore, it is important to keep in mind that actual aggregate costs may be slightly higher. In the course of our study, two main nonquantifiable cost items were identified.
 - **Adjustment costs:** these are the costs of adjusting systems and data collection when definitions or categories on existing forms change. A number of associations informed us that the HC frequently updates the definitions for particular data items and that this in itself imposes a process cost upon associations.
 - **Acquaintance costs:** these are the costs of acquainting new lead regulators and other officials with the association. Similar to above, associations informed us that when key regulatory contact staff change, there is a process cost associated with establishing a relationship with new people.

We have estimated the aggregate level costs associated with the regulatory framework

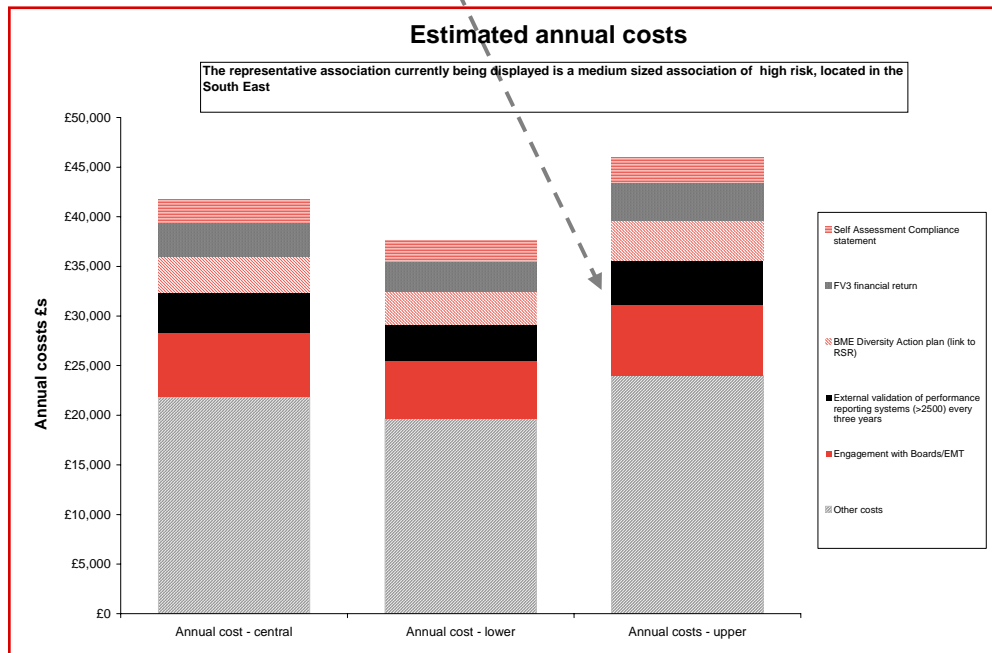
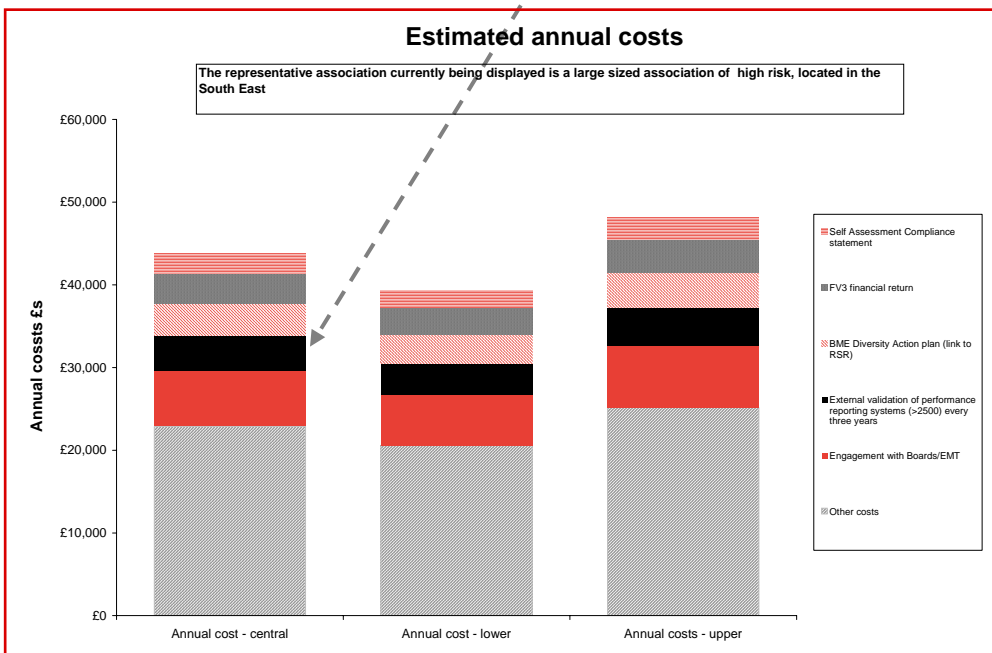
- Our analysis of costs allows us to review:
 - aggregate level costs to the sector as a whole; and
 - how costs vary by type of representative association.
- As with benefits, costs are calculated at the level of individual representative associations. This allows us to build up a picture of how costs vary by size, location and risk level of association. These individual cost calculations are then aggregated up to provide an estimate of sector wide costs. In addition to this, the HC provided us with information on the running costs of the HC relating to regulation, which are included in our aggregate cost estimates.
- Our results indicate that aggregate level costs are large, but are substantially lower than the aggregate benefits reported earlier. We estimate that costs are between £277m and £327m on a PV basis over five years.
- At an aggregate level, costs are driven by:
 - the time required to comply with regulatory items;
 - the frequency with which regulatory items must be completed; and
 - the cost of time (i.e. wage rates).



The most costly regulatory burdens vary by type of association, but tend to be: the RSR, EVRS, inspection action plans, BME action plans and engagements with the Board

- Our results reveal that both total cost, and cost composition varies by type of association. To illustrate this, the charts shown below illustrate cost composition for two representative associations. Full details of cost composition can be found in Annex D.
- The charts indicate only the total cost associated with the five most expensive regulatory activities.¹ It is not possible, within the scope of this project, to separately identify whether the benefits associated with these particular activities outweigh these costs. If the benefits for any individual item outweigh the costs associated with that item, then that activity is worthwhile, even if the costs are high.
- Consequently, this analysis can be used to indicate where further investigation may be warranted: whether the most costly activities are justified by greater benefits.

External validation of performance reporting (EVRS) is costly but may also have distinct future benefits if it reduces the need for associations and the HC to spend a long time verifying data.



1: in these and subsequent figures, “risk” is based on the HC’s risk model which looks closely at the potential impact of the association.

Relating individual costs to benefits – a case study on external validation

- Even regulatory items which appear costly may themselves have a net benefit. For example, if it was thought that a particular regulatory item was directly related to borrowing rates then the benefit associated with that item is likely to outweigh the costs, even if the costs are high.
- In other cases, the regulator may be limiting the cost of regulations by using its discretion over how policies are implemented in a manner designed to minimise the cost to associations and the tax payer.
- Whilst it was beyond the scope of this study to match individual regulatory items to specific benefits it would clearly be inappropriate to conclude that costly items should be reformed or removed without giving due consideration to the associated benefits. To illustrate this point, we present a case study concerning the external validation of performance reporting systems.

Case study on the External Validation of Reporting Systems

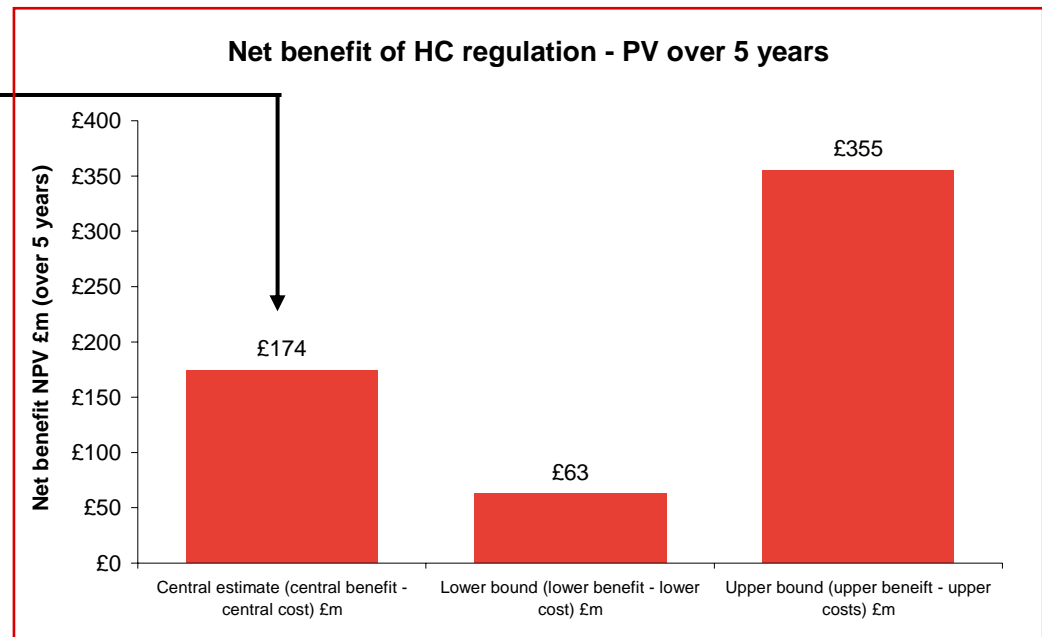
- The external validation of reporting systems (EVRS) requirement is designed to ensure that the data collected by the HC from housing associations is accurate, reliable and consistent. The EVRS requires housing associations to allow an independent third party to undertake an assessment of the extent to which the association has in place robust arrangements for collecting, recording, calculating and reporting certain performance information.
- The HC suggests that this requirement is particularly important as data collected in the RSR and CORE represents the main source of information on the sector available to Ministers, their stakeholders and the wider public.
- The illustrative cost composition charts shown earlier indicated that the EVRS is a particularly costly item. This reflects the fact that, of the items included within our counterfactual, associations indicated that a considerable amount of time was taken up complying with the EVRS.
- However, the time and other costs associated with the EVRS only give half of the picture. It seems likely that there a range of benefits associated with the EVRS that are not easily quantifiable. For example, the sector as a whole clearly benefits from having data collected and reported in a manner that is both consistent and robust. Additionally, by ensuring the validity of reporting, the EVRS may contribute to the overall level of confidence by associations and outside institutions in the sector – and means that the HC does not need to call around associations checking individual data items.
- This case study illustrates the importance of considering what benefits individual items may yield. Whilst identifying the most costly regulatory requirements is in itself an important and necessary task, it is not sufficient for the purpose of making decisions around reforming or removing existing regulatory requirements. Furthermore, it illustrates the need to fully understand the counterfactual in interpreting the results. In this analysis, EVRS is not part of the counterfactual.

NET BENEFIT

Overall, net (quantifiable) benefits are substantially positive, but costs are high in some areas

- Our aggregate level results indicate that there is a positive net benefit of the HC's regulatory framework. The net benefit of the regulatory framework ranges from about £63 million to £335 million over five years (in PV terms).
- The wide range of results shown reflects the fact that our aggregate analysis:
 - is based on a small sample of individual associations; and
 - has taken into account the uncertainty around key cost and benefit items.
- The aggregate net benefit estimate is derived from detailed analysis of costs and benefits for individual representative associations. These individual estimates were aggregated up, based on an assumption of how many associations there are of each type. A consequence of this approach is that, any error made in estimating costs for an individual association will be multiplied by the number of associations of that given type. Further details of the estimation process can be found in Annex A.

The size of the aggregate benefit is partially driven by the assumed savings in borrowing cost. Lenders tended to indicate a saving attributable to the HC regulatory framework of 30 – 35 basis points (the central case)



Scenario analysis reveals that total net-benefit is sensitive to the assumptions made regarding the benefits of lower interest rates

- In keeping with best practice for cost-benefit analysis, we have run sensitivities around the key areas of uncertainty. We considered sensitivities around:
 - the time estimates provided by housing associations: central estimate were based on the average time requirements indicated by the housing associations. We then considered upper and lower estimates for time requirements based on +/- 10% of the estimates
 - the extent to which the regulatory framework enables associations to borrow at lower rates: discussions with lenders and associations informed our central estimate. The view of lenders was that the average lending rate would be 0.35% higher in the absence of the regulatory framework. Our lower case assumes that a 0.25% discount exists and our upper estimate is based on a discount of 0.50%.
- The table below shows how total net benefit varies with the sensitivities outlined. The total benefit table reveals that benefits are sensitive to the interest rate assumption made.

Net benefit summary - NPV £m over five years

TOTAL BENEFITS OVER FIVE YEARS - REAL TERMS

central estimate (£m)	£476
lower bound (£m)	£340
upper bound (£m)	£682

Based on views of borrowing rates with and without the HC's regulatory role (see pages 26 and 27)

TOTAL COSTS OVER FIVE YEARS - REAL TERMS

central estimate (£m)	£302
lower bound (£m)	£277
upper bound (£m)	£327

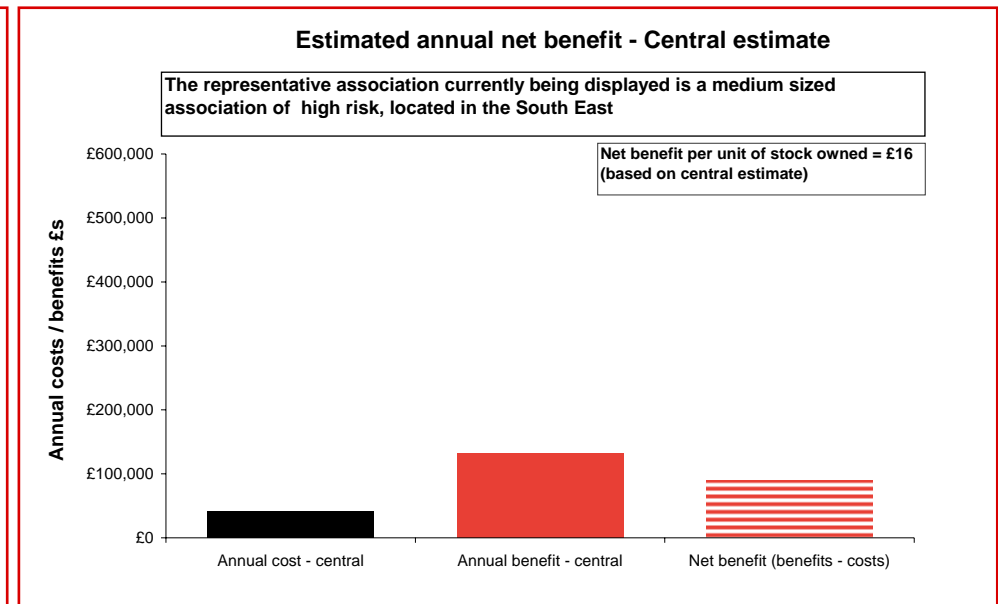
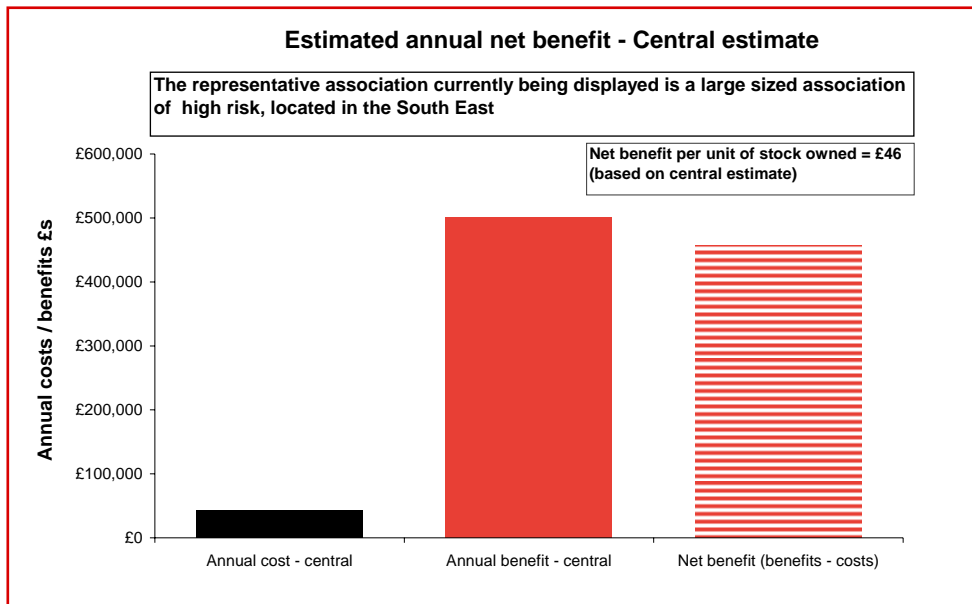
Based on associations views about the amount of time it takes to comply with the regulatory framework over and above time they would otherwise spend on ensuring good financial and governance arrangements

TOTAL NET BENEFIT OVER FIVE YEARS - REAL TERMS

Central estimate (central benefit - central cost) £m	£174
Lower bound (lower benefit - lower cost) £m	£63
Upper bound (upper benefit - upper costs) £m	£355

The net benefit varies by type of association. The net benefit tends to increase with the size of the association.

- The (quantifiable) benefit is driven by savings from lower lending rates. Larger associations, who borrow more, see greater benefits compared to smaller associations.
- The (quantifiable) cost is driven by the time associations have to spend interacting with the HC and by the time cost (i.e., wage rates) specific to associations. Consequently, high risk associations tend to see greater costs than low risk associations.
- The cost-benefit model produces benefit, cost and net benefit calculations for each of the 108 representative associations (i.e., a representative association for each region, size and risk-type). The charts below illustrate the impact for two types of representative associations.¹ Annex E provides an illustration of how net benefit varies across a wide range of representative associations.



1: in these and subsequent figures, “risk” is based on the HC’s risk model which looks closely at the potential impact of the association.

There does appear to be some scope for achieving the same outcomes at lower cost if a risk based framework is implemented rigorously

- The study has primarily focused on cost-benefit analysis. However, during the course of the study it also became apparent that it would be important to consider whether the current regulatory regime is consistent with best practice.
- The purpose of this is to consider (independently of whether benefits exceed costs) whether the same regulatory outcomes could be achieved at lower cost.
- In March 2005, Philip Hampton published his report: *Reducing administrative burdens: effective inspection and enforcement.* This report, which was based on a comprehensive study of 63 national regulators, outlined a set of best practice principles for regulators. Full details of the Hampton Report's findings can be found in Annex B.
- Of most relevance to the HC's framework is the discussion of risk assessment set out in the Hampton report. The report emphasises the need to use risk assessment as the foundation of all aspects of regulatory work. This would include:
 - varying data requirements according to risk (including sending different formats of forms to organisations of varying risk);
 - varying non-compliance penalties according to risk; and
 - setting inspection programmes according to risk.
- The central aspects of the HC's regulatory framework are consistent with best practice principles. However, the HC's regulatory framework is not always implemented in-line with these principles and risk assessment could provide a more robust classification.
- The HC is only just in the process of implementing a more risk-based regulatory framework. Consequently, the associations consulted had not yet experienced the full scope of the new programme. Given their feedback on the previous approach it will be important to monitor whether:
 - the scope of items which vary by risk could be expanded beyond those currently indicated under the HC's risk-based approach; and
 - the extent of the variation in regulatory burden itself could be greater across risk types.
- By tailoring regulatory requirements to the characteristics of associations, the HC would ensure that their framework was more consistent with best practice; and would help achieve existing outcomes at lower cost.

The scope for varying regulatory burden is greater in some areas than others

- The HC is currently in the process of introducing a risk based approach to regulation. This approach involves assessing the probability and impact of significant risks at each lead association; and tailoring the level of regulatory engagement accordingly. In principal, this approach should allow the HC to deliver more proportionate regulation to the sector.
- In considering whether risk based regulation could be further developed, it is important to examine the role of the HC in the wider context of the sector. As outlined in the introduction, there are many agents with a regulatory role in the social housing sector. Due to this, we suggest that the scope of varying the HC's regulatory engagement is greater in some areas than others. To illustrate this point, we set out a case study around anti social behaviour policy.

Case study on anti social behaviour policy

- Under section 12 of the Anti Social Behaviour Act (2003) all housing associations must produce an anti social behaviour policy (ASBP). The HC itself has a role in ensuring and assessing compliance with this requirement, which consists of:
 - expecting associations to certify that they have complied;
 - undertaking more detailed reviews of associations where risk assessment may indicate non-compliance; and
 - in making an assessment of compliance, the HC will take into consideration relevant findings from inspection.
- The ASBP provides therefore, a good illustration of an area which, whilst falling under the regulatory framework of the HC, is actually a statutory requirement for housing associations.
- The HC might have some limited flexibility in the extent to which it monitors compliance. For example, it could adopt a more active monitoring role for associations considered more likely to fail to comply. However, as the ASBP is a requirement by law, there is only a very limited degree to which tailoring the approach to monitoring would actually lessen the regulatory burden upon associations.
- Our detailed cost composition breakdown outlined in annex D indicates that the ASBP is a relatively costly item for associations. Given that, it would seem sensible to consider whether the burden could be reduced through risk based regulation. However, due to the fact that the HC essentially acts as a government agent in this area, the scope of lessening the burden is, in reality, limited.
- It is also important to recognise that associations would have to take some action against ASB even in the absence of the HC. The costs of having a policy are included in the cost of regulation because associations may choose to approach the issue differently in the absence of regulation. However, by including the full costs a conservative estimate of net quantifiable benefits is derived because some of these costs would likely be incurred by associations in any event.
- This case study illustrates the importance of understanding the overall environment in which the HC operates. As there are many bodies which have a regulatory role in the social housing sector, the scope of the HC for varying its regulatory burden is greater in some areas than others.

This work should be followed up with a more detailed assessment of the HC's approach to regulation

- The results presented in this report are based on a relatively short project to apply cost-benefit analysis to the regulatory framework overseen by the HC. During the course of the project a number of important areas were uncovered where further investigation may be warranted or refinements could be made to the regulatory process. The most important areas for further work are:
- **Risk based regulation:**
 - How should reporting requirements vary based on the risk category of an association? Is there scope to differentiate reporting requirements to a greater extent across risk types while meeting HC's statutory obligations? (see Annex C) This should pick-up on recommendations arising from Hampton.
 - Implementation of the risk-based framework and particularly the categories used – would a finer gradation be more appropriate? What are the implications for the links between HC's monitoring activities and due diligence and appraisal associated with grant and new investment?
- **Cost benefit analysis:**
 - Expanded survey to test robustness of findings in this report
 - Further work on degree to which monitoring duties of HC affect lending rates (e.g. investigation of differences in lending practices to private builders, other similar entities like Medway), reasoning of credit committees and the impact of a shift to risk-based regulation on lending to the sector
 - Quantification of benefits that arise from specific regulatory instruments and/or requirements (e.g. specific benefits arising from requirement to get an external validation of performance reporting systems)
 - Clear definition and potentially quantification of some of the wider benefits (e.g. benefit to residents of living in housing subject to the HC regulatory regime compared to private sector housing)
- **HC Strategy:**
 - **Role of HC within government:** better mapping of which government policies and initiatives the existence of the HC facilitates, and government would find hard to do in its absence (see Annex C).
 - Full response to Hampton, BRTF and other upcoming reports in light of HC's actions and plans and any post-election changes to government approach to regulatory burdens generally and the housing sector specifically

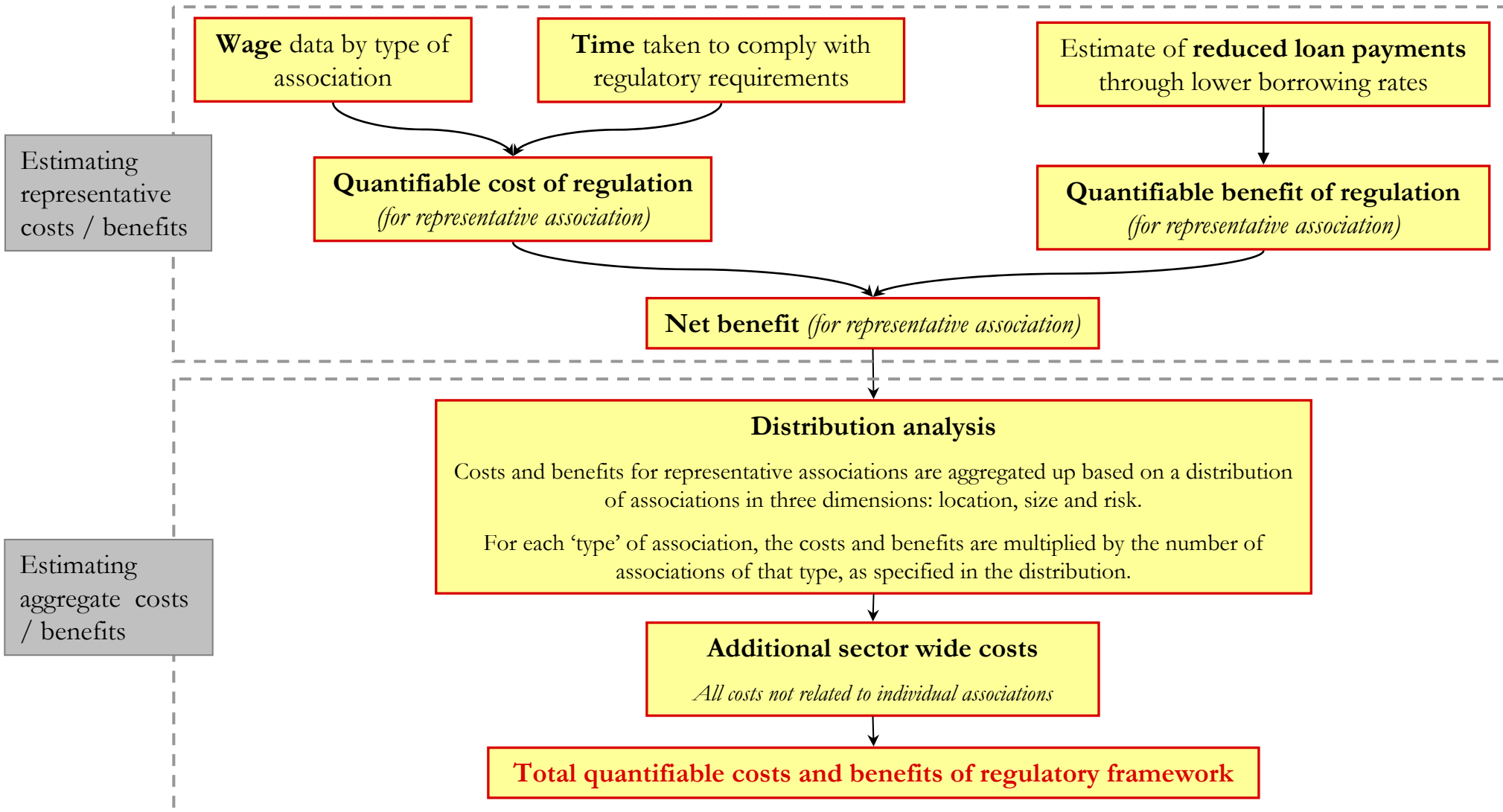
ANNEX A – THE COST-BENEFIT ANALYSIS MODEL

Overview of the cost-benefit analysis model

- In order to estimate the costs and benefits of the HC's regulatory framework, Frontier developed a cost-benefit analysis model. Based on a range of inputs relating to specific cost items and benefits, the model generates central, lower and upper estimates for the net benefit of the HC's regulatory framework.
- The model has two main functionalities, which are:
 - a calculation of detailed cost and benefit estimates for individual 'representative' housing associations; and
 - an aggregation of individual level estimates for representative associations to estimate total costs and benefits of the regulatory framework.
- The cost-benefit analysis model also allows the user to run a number of 'what if' scenarios, in which key cost and benefit parameters can be flexed. For example, the user can specify what proportion of the benefit arising from lower borrowing rates is attributable to the regulatory framework of the HC.
- Based on the analysis described in detail within this Annex the model produces a range of outputs, which include:
 - detailed cost breakdowns for each representative association;
 - central, lower and upper net benefit estimates for each representative association; and
 - an estimate of the overall net benefit of the regulatory framework.
- This Annex provides a detailed description of the cost-benefit analysis model, including an overview of the input data used in the analysis as well a description of the model's functionality. The Annex includes:
 - an illustrative diagram of the model's structure;
 - defining representative associations;
 - estimating costs for representative associations;
 - estimating benefits for representative associations; and
 - estimating total costs and benefits of the regulatory framework.

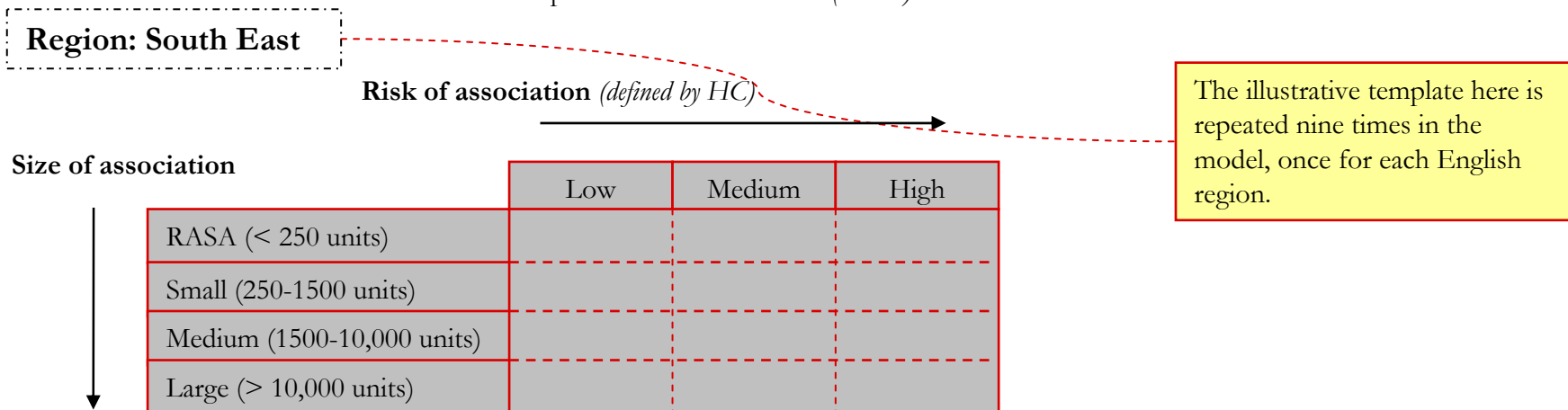
Illustration of model structure

- The diagram below provides an overview of the structure of Frontier's cost-benefit analysis model. Details of the model's functionality follow.



Defining representative associations

- The first stage of the analysis involved estimating the costs and benefits for individual representative associations. We considered that the costs and benefits of the regulatory framework might vary in three dimensions:
 - location of association (region);
 - size of association (number of units owned & managed); and
 - risk of association.
- The three dimensions outlined could drive costs and benefits in a number of ways. For example, the location of an association would impact on the wage rates paid to staff. Similarly, the size of an association might partly drive how much an association borrows to invest in development; and thus the extent to which the association benefits from lower interest rates. Similarly, with the HC's move towards more risk-based regulation, the perceived riskiness of an association is likely to influence the requirements made of that association by the HC.
- The cost-benefit analysis model was therefore designed to calculate costs and benefits for representative associations in these three dimensions. The model allows the user to review the costs and benefits for a representative association:
 - of four size groups;
 - three risk groups; and
 - in any one of the nine English regions.
- The template below illustrates how representative associations are considered in any given region. Given these three dimensions, the model can calculate costs and benefits for 108 representative associations ($4*3*9$).



Estimating costs for representative associations

- The costs of complying with the HC's regulatory framework were calculated on the basis of: (time taken to comply with regulation * cost of time – i.e., wage rates), see main report for details.
- **Time taken to comply with regulation:** The data used in our analysis was provided to Frontier by the housing associations with whom meetings were held. Frontier asked these associations to complete an Excel template, outlining how much time the associations had taken to comply with regulatory items. For the items listed in the template, associations were asked to indicate:
 - how many times the item was undertaken per year;
 - how much time in total was assigned to completing the task; and
 - how that time was split between chief executives, senior managers, middle managers and junior managers.
- **Wage data by 'type' of association:** In order to calculate the costs for representative associations, we obtained data that allowed us to estimate how wages vary by location and size of association. Frontier used data from two sources for the purposes of this analysis:
 - wage data from housing association accounts, supplied by the HC (which indicated how wages varied according to size and location of association); and
 - the housing association salaries and benefits survey 2003/04 (which indicated how wages varied by seniority of association employee and by location of association).
- Based on an assumed five day working week at seven hours worked per day, Frontier then estimated hourly wage rates for each type of representative association and by seniority of employee.
- Using the data outlined above, the model estimates costs for each of the representative association types described earlier.

Estimating benefits for representative associations

- The model also estimates the quantifiable benefits derived from the regulatory framework, for each representative association. For the purposes of our analysis, the quantifiable benefit is the lower borrowing rates achieved by housing associations. As outlined previously, the model allows the user to specify what proportion of this benefit is attributed to HC regulation.
- **Estimating the benefits of lower borrowing rates:** In order to estimate the benefits of lower borrowing rates, Frontier obtained data from the Private Finance Regulatory Return (PFRR) for 2004/05. This data contained information on: loan facilities, loans outstanding and length of payment terms for individual associations. Based on this information, Frontier estimated the benefits achieved from lower borrowing rates as: (Payments made under commercial loan rates – Payments made as indicated in PFRR data.) This consisted of the following steps:
 1. For each size of association (defined by stock owned) we calculated the average loan outstanding, average interest rate and average length of payment term.
 2. Based on this information, we estimated the stream of payments paid by associations of different sizes under current interest rates.
 3. Following this, we made an assumption as to the interest rates paid under commercial terms (the exact interest uplift applied was an input specified by Frontier and we estimated benefits based on central, low and high cases) – from this we estimated what payment stream would be necessary in order for the association to clear the (average) loan outstanding under the existing (average) term length.
 4. The difference between the payment stream under existing arrangements [Step 2] and that estimated using commercial rates [Step 3] then provides an estimate of the total benefit of lower borrowing rates over the average payment term.
 5. This sum, divided by the average payment term length provides an estimate of the average annual benefit of lower borrowing rates for each size of association. Clearly, the more that an association borrows, the greater this benefit becomes and, as typically the large associations borrow more than the smaller ones, the benefit tends to be greatest for large associations.

Estimating the total costs and benefits of the regulatory framework

- Based on the steps outlined previously, the model calculates costs and benefits for each of the association types described. In order to provide an estimate of the total costs and benefits of the regulatory framework, the model aggregates up the costs and benefits of individual representative associations based on:
 - distribution analysis – i.e., an assumption about how many associations of each type there are; and
 - a consideration any additional costs / benefits that are sector wide; and not included in the analysis of representative associations.
- **Distribution analysis:** Having estimated the costs and benefits for each type of representative association, calculating the total costs and benefits requires us to make an assumption about how many associations there are of each type. Frontier was provided with a ‘Group Risk Report’ by the HC, which allowed us to examine the spread of associations by:
 - location (UK region);
 - size (stock owned and managed); and
 - risk (low, medium, high - as defined by the HC).
- Based on this information, we calculated how many associations there are of each of the 108 types defined earlier. For each type of association, the model calculates: (costs of association type A) * (number of associations of type A). An identical calculation is undertaken for the benefits.
- One difficulty with this approach is that any small error in estimating individual level costs and benefits will be magnified considerably during the aggregation process. For example, if an association overestimates the cost of a particular regulatory item, that overestimate will be multiplied by our estimate of how many associations there are of that type.
- **Consideration of further costs:** In addition to the aggregation of individual association level costs and benefits, in order to calculate the total net benefit of the regulatory framework, we must take account of any costs and benefits that arise at a sector-wide level. For the purposes of our analysis, we identified the cost of running of the HC as a quantifiable example of a sector-wide cost. In order to estimate this, the HC provided Frontier of an estimate of the HC’s running costs specifically associated with regulation.

ANNEX B – SUMMARY OF BEST REGULATORY PRACTICE AS SET OUT IN THE HAMPTON REPORT AND BY THE BRTF

The 2005 Hampton Report outlined a set of best-practice principles for regulators

- In March 2005, Philip Hampton published his report: *Reducing administrative burdens: effective inspection and enforcement.* This report, which was based on a comprehensive study of 63 national regulators, outlined a set of best practice principles for regulators.
- This annex contains a list of the Hampton report's findings regarding current regulatory behaviour. The bullet points listed below reveal the main shortcomings highlighted by Hampton, which were:
 - risk assessment is patchy;
 - regulators do not put enough emphasis on providing advice to assist compliance;
 - too many overlapping forms and data requirements;
 - regulators lack tools to punish repeat offenders or, to reward compliance;
 - the structure of regulators is complex; and
 - there are too many interfaces between businesses and regulators.
- Given the deficiencies reported in current regulatory behaviour, Hampton made a number of recommendations, intended to move regulators towards a set of 'best practice' principles. The key recommendations outlined in the report are summarised as:
 - comprehensive risk assessment should be the foundation of all regulatory enforcement programmes;
 - there should be no inspections without a reason, and data requirements for less risky businesses should be lower than for riskier businesses;
 - resources released from unnecessary inspections should be redirected towards advice to improve compliance;
 - there should be fewer, simpler forms;
 - data requirements, including design of forms, should be coordinated across regulators;
 - when new regulations are being devised, departments should plan to ensure enforcement can be as efficient as possible; and
 - 31 national regulators should be reduced to 7 thematic bodies.

The report emphasised using risk assessment to inform all aspects of regulatory work

- The Hampton report emphasises the need to use risk assessment as a means of determining the need for regulatory intervention. The report found that currently, risk assessment is most commonly used to determine inspection programmes. However, Hampton suggests that risk assessment should inform all aspect of regulatory work. This would include:
 - varying data requirements according to risk (including sending different formats of forms to organisations of varying risk);
 - varying non-compliance penalties according to risk; and
 - setting inspection programmes according to risk.
- In order to improve risk assessment, the Hampton report outlines a number of recommendations. Namely, that risk assessment should:
 - be open to scrutiny;
 - be balanced in including past performance as well as potential future risk;
 - use all available good quality data;
 - be implemented uniformly and impartially;
 - be expressed simply, preferably mathematically;
 - be dynamic, not static;
 - be carried through into funding decisions;
 - incorporate deterrent effects; and
 - always include a small element of random inspection.

The BRTF separately made recommendations in two areas: how to assess the cost of regulation...

- The BRTF describes the Standard Model for the assessment of regulatory costs. This has distinct shortcomings. In particular, it is not a full cost-benefit analysis. However, it does provide a pragmatic approach to calculating the cost of regulation.
- The BRTF describes a general approach in which each information obligation associated with every regulation is identified.
- The regulatory cost imposed by each obligation is estimated based on the time it takes to comply:

$$N * W * T$$

where,

N = number of businesses affected by obligation

W = the hourly tariff of those involved in meeting the obligation

T = The number of hours taken to meet the administrative obligation in a year

- The BRTF states that *“The standard cost model provides a stylised estimate of the administrative burden. It does not pretend to measure the true administrative burden. Rather, it produces a standardised set of numbers which when aggregated together gives... an overall picture of regulation, thereby enabling it to identify actions that will reduce the burden.”*
- The BRTF emphasises that measurement is only one component in reducing the overall burden. Equally important are:
 - political commitment to sensible reductions that follow from the measurement of the burden
 - an institutional structure that provides clear incentives to make the necessary reductions.

...and how to limit the total number of regulations

- The BRTF also recommends a “one in, one out” policy for new regulations. It recommends this approach on the basis that it is an easily understandable description of the more general desire to make sure those involved in developing new regulations take account of their impact in addition to all the existing regulatory burdens.
- The BRTF claims this approach emphasises the need to make choices: “*If ministers do want new laws they will need to prioritise and drop other proposals - thus **stemming the flow**, or repeal existing laws - thus **reducing the stock**.”*”
- The main weakness of this approach is that it does not take into consideration the net benefits of new (or existing) regulations. “One in, one out” and the standard model approach tend to regard all regulations as equivalent.
- It may be important, in implementing the important messages found here, in Hampton and elsewhere (e.g. Gershon) to consider in more detail the impact of particular regulations and to decrease the burdens of those that have the smallest positive impact (and all those with negative impacts), rather than cutting those that have the largest total cost.

ANNEX C – HC OBJECTIVES AND REGULATORY CODE

Mapping HC objectives to the regulatory code

- The table below illustrates how the objectives of the HC map to individual regulatory code items. A 'tick' indicates that the code item maps directly to a HC objective. This is a subjective exercise.

Objectives	Regulatory code													
	Viable				Governance				Management					
	Financial resource	Business plan	Fulfil loan covenants	Manage risks	Within the law	Effective board	Relationships with stakeholders	Use assets only for social housing	Residents contribute	Equal ops	Appropriate rents	Appropriate skills	Value for money	Homes in lettable condition
Fair rent structure									✓		✓		✓	
Understandable rent structure									✓		✓			
High quality governance	✓	✓	✓	✓		✓		✓						
Probity of the sector	✓		✓	✓	✓	✓	✓	✓		✓		✓	✓	✓
Decent homes									✓				✓	✓
Value for money									✓		✓		✓	

Source: Frontier economics, adapted from Housing Corporation

Objective	Measure	Target
Maintaining a viable housing association sector and moving to a fairer more understandable rent structure.	Set of indicators based on financial health. All sectors to have a rent restructuring plan.	Improvement in financial indicators by 2003/04. 100% of associations to have rent plan by April 2002.
High quality governance and probity.	Independent review of regulation including consultation.	Review and report by end 2003 (now complete – led to updated regulatory code).
Decent homes.	Housing association must meet government set 'decent homes' criteria.	One third of currently unfit homes to meet 'decent homes' criteria by 2004. All social housing to meet standard by 2010.
Value for money.	Set of best value performance indicators to be developed.	Improvement on 2001/02 baseline by 2003/04.

Table 1 HC objectives and targets

Source: Frontier economics, adapted from Housing Corporation

- The table shown left (adapted from the regulatory code and the HCs three-year corporate strategy) sets out the high-level objectives of the HC, including indicators as to how progress can be measured and what targets are / have been in place.

ANNEX D – ANNUAL COST ESTIMATES OF REGULATORY ITEMS

ANNEX D – ANNUAL COST OF REGULATORY ITEMS

- The tables below show regulatory items ranked by annual costs for representative associations. These represent the additional costs associations attributed to the HC and its regulatory framework.
- Variance in cost items by risk reflects the Housing Corporation’s published guidelines set out in ‘How we regulate 2: Risk based regulation.’ These guidelines provide a summary of how requirements will vary by risk – this covers the following regulatory items:
 - FV3 (not usually required for low risk associations);
 - Engagement with the board (tailored by risk level); and
 - HCA / AVR (HCA will be every two years for low risk associations).

Regulatory items ranked by annual cost estimates

LOW RISK ASSOCIATIONS

Ranks in order	Regulatory item	CENTRAL ESTIMATE OF COSTS
1	External validation of performance reporting systems (>2500) every three years	£4,244
2	BME Diversity Action plan (link to RSR)	£3,879
3	Self Assessment Compliance statement	£2,405
4	Best Value action plans / continuous improvement plans	£2,149
5	RSR	£2,100
6	Complaints policy and procedure	£1,789
7	Organisation structure review every 2-3 years	£1,591
8	Tenant / resident survey (2-3 years)	£1,430
9	Anti-social behaviour policy	£1,338
10	FV5 financial return	£1,326
11	CORE - report on lettings	£1,249
12	Risk management strategy	£1,115
13	Business continuity plan	£926
14	Tenant / resident involvement plans	£857
15	Asset management strategy	£797
16	Corporate structure review every 2-3 years	£681
17	Asbestos strategy	£665
18	Governance documents - terms of ref.	£542
19	Board skills audit / review annually	£396
20	Board and board member appraisal annually	£331
21	Change in Registry details and changes in structure (office, HA name, etc.)	£309
22	Business case for board payment	£204
23	Treasury strategy reviewed annually	£184
24	Financial standing orders	£177
25	Framework of delegation reviewed annually	£174
26	Checking' regulation outputs (HCA, AVR)	£158
27	Schedule 1 register	£130
28	Notification of change of address & website	£90
29	Notification of change of auditors	£45
30	Notification of change of solicitors	£45
31	Notification of change of officers/senior staff	£45
32	Notification of change of partnership arrangements	£45
33	Notification of change of unregistered subsidiaries	£45
34=	FV3 financial return	£0
34=	Long term financial model	£0
34=	Notification of board payment	£0
34=	Adopting charitable status	£0
34=	Engagement with Boards/EMT	£0
34=	Registration and deregistration	£0
34=	Structure changes (ToE, mergers etc.)	£0
34=	Inspection action plans	£0

Regulatory items ranked by annual cost estimates

MEDIUM RISK ASSOCIATIONS

Ranks in order	Regulatory item	CENTRAL ESTIMATE OF COSTS
1	Engagement with Boards/EMT	£6,769
2	External validation of performance reporting systems (>2500) every three years	£4,244
3	BME Diversity Action plan (link to RSR)	£3,879
4	FV3 financial return	£3,575
5	Self Assessment Compliance statement	£2,405
6	Best Value action plans / continuous improvement plans	£2,149
7	RSR	£2,100
8	Complaints policy and procedure	£1,789
9	Organisation structure review every 2-3 years	£1,591
10	Tenant / resident survey (2-3 years)	£1,430
11	Anti-social behaviour policy	£1,338
12	FV5 financial return	£1,326
13	CORE - report on lettings	£1,249
14	Risk management strategy	£1,115
15	Business continuity plan	£926
16	Long term financial model	£894
17	Tenant / resident involvement plans	£857
18	Asset management strategy	£797
19	Corporate structure review every 2-3 years	£681
20	Asbestos strategy	£665
21	Governance documents - terms of ref.	£542
22	Board skills audit / review annually	£396
23	Board and board member appraisal annually	£331
24	Checking' regulation outputs (HCA, AVR)	£316
25	Change in Registry details and changes in structure (office, HA name, etc.)	£309
26	Business case for board payment	£204
27	Treasury strategy reviewed annually	£184
28	Financial standing orders	£177
29	Framework of delegation reviewed annually	£174
30	Schedule 1 register	£130
31	Notification of change of address & website	£90
32	Notification of change of auditors	£45
33	Notification of change of solicitors	£45
34	Notification of change of officers/senior staff	£45
35	Notification of change of partnership arrangements	£45
36	Notification of change of unregistered subsidiaries	£45
37=	Notification of board payment	£0
37=	Adopting charitable status	£0
37=	Registration and deregistration	£0
37=	Structure changes (ToE, mergers etc.)	£0
37=	Inspection action plans	£0

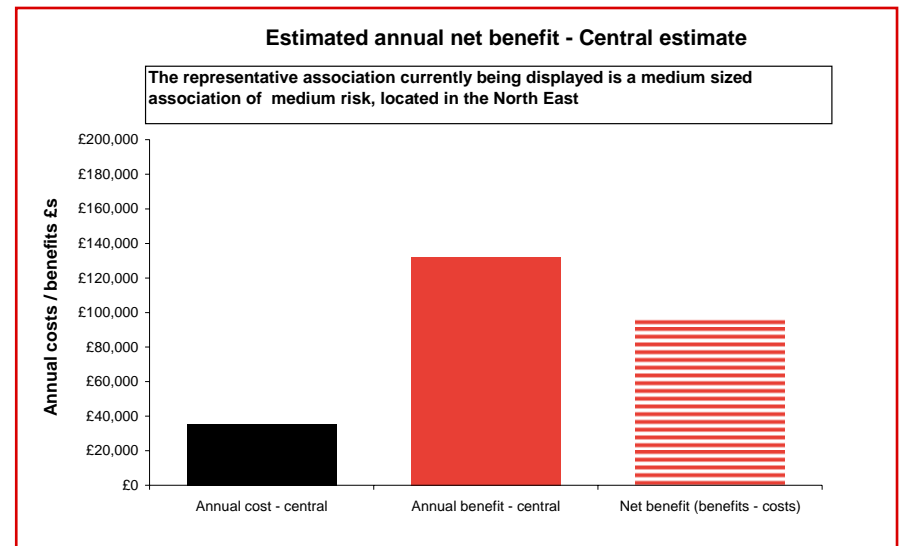
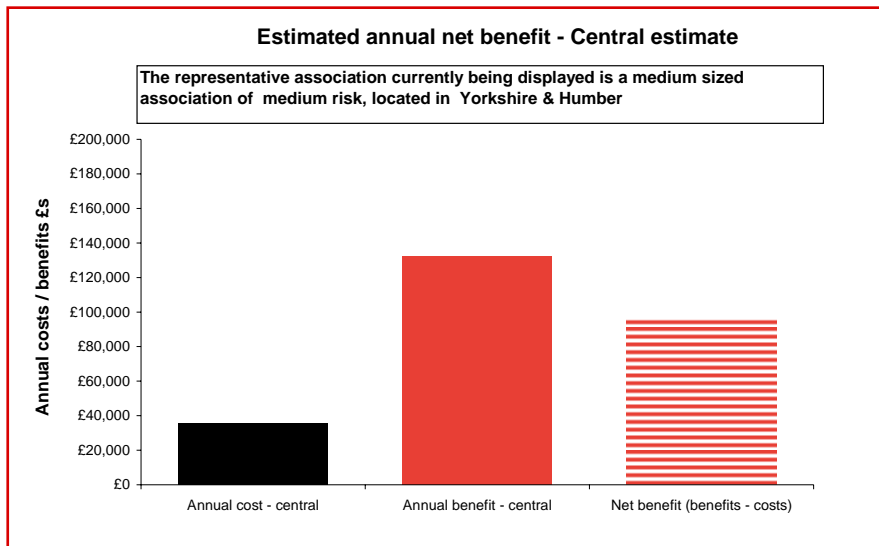
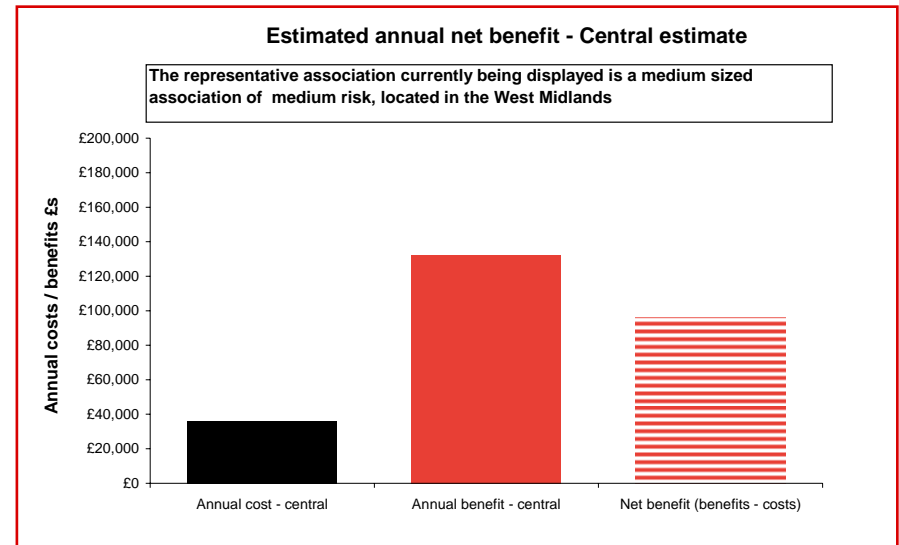
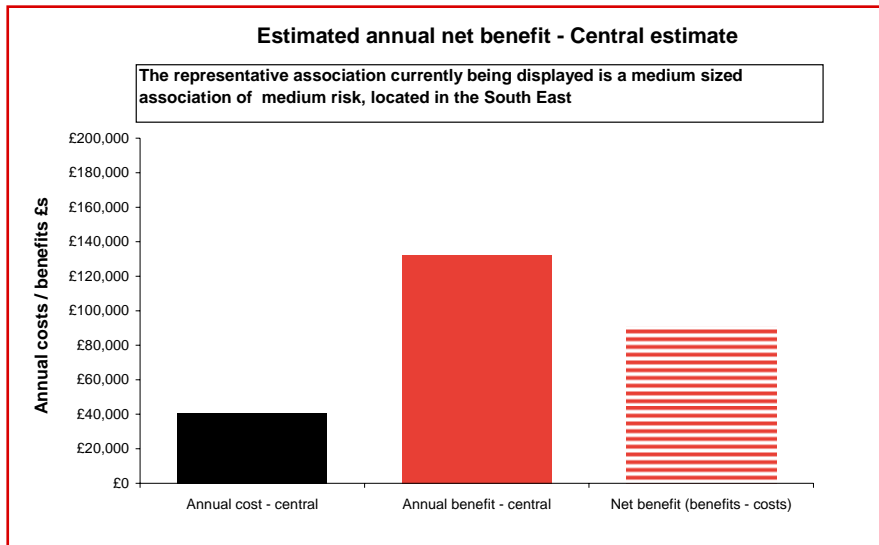
Regulatory items ranked by annual cost estimates

HIGH RISK ASSOCIATIONS

Ranks in order	Regulatory item	CENTRAL ESTIMATE OF COSTS
1	Engagement with Boards/EMT	£6,769
2	External validation of performance reporting systems (>2500) every three years	£4,244
3	BME Diversity Action plan (link to RSR)	£3,879
4	FV3 financial return	£3,575
5	Self Assessment Compliance statement	£2,405
6	Best Value action plans / continuous improvement plans	£2,149
7	RSR	£2,100
8	Complaints policy and procedure	£1,789
9	Long term financial model	£1,788
10	Organisation structure review every 2-3 years	£1,591
11	Tenant / resident survey (2-3 years)	£1,430
12	Anti-social behaviour policy	£1,338
13	FV5 financial return	£1,326
14	CORE - report on lettings	£1,249
15	Risk management strategy	£1,115
16	Business continuity plan	£926
17	Tenant / resident involvement plans	£857
18	Asset management strategy	£797
19	Corporate structure review every 2-3 years	£681
20	Asbestos strategy	£665
21	Governance documents - terms of ref.	£542
22	Board skills audit / review annually	£396
23	Board and board member appraisal annually	£331
24	Checking' regulation outputs (HCA, AVR)	£316
25	Change in Registry details and changes in structure (office, HA name, etc.)	£309
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33	Notification of change of solicitors	£45
34	Notification of change of officers/senior staff	£45
35	Notification of change of partnership arrangements	£45
36	Notification of change of unregistered subsidiaries	£45
37=	Notification of board payment	£0
37=	Adopting charitable status	£0
37=	Registration and deregistration	£0
37=	Structure changes (ToE, mergers etc.)	£0
37=	Inspection action plans	£0

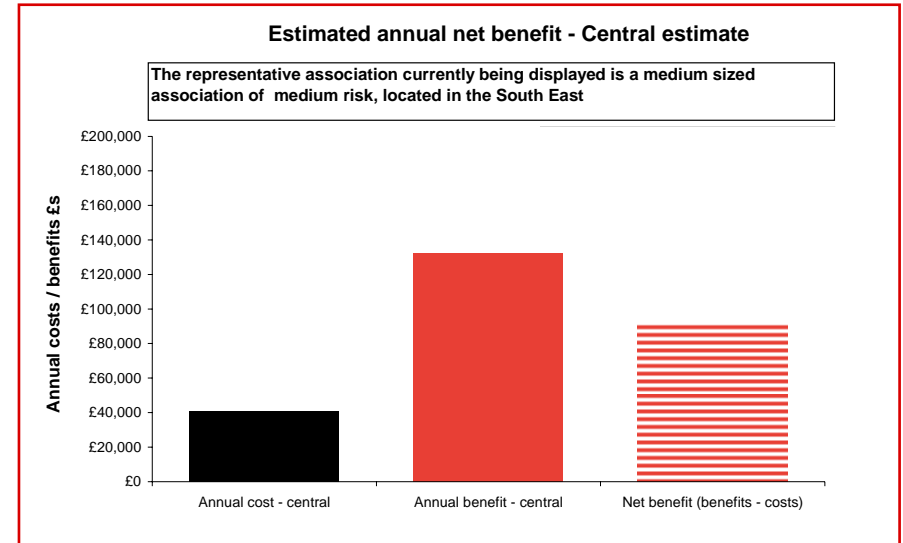
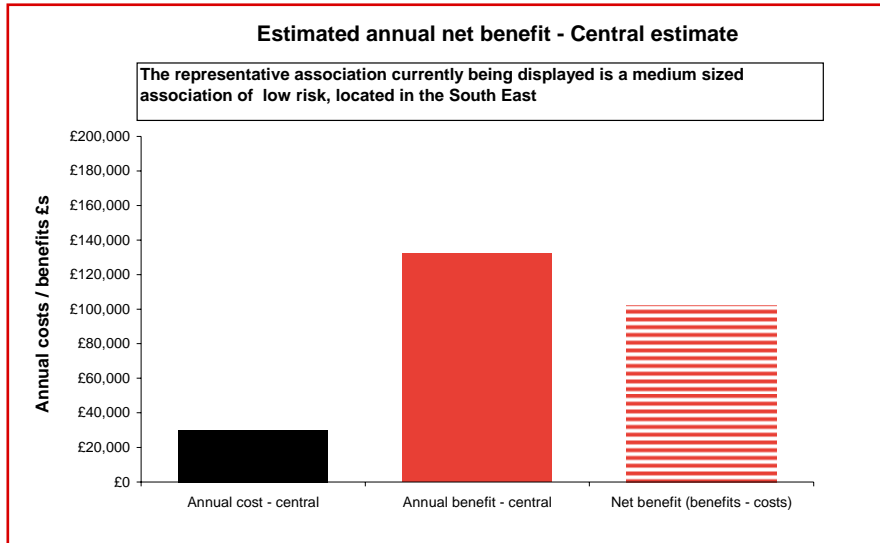
ANNEX E – NET BENEFIT BY TYPE OF REPRESENTATIVE ASSOCIATION

Net benefit will vary slightly by region, this is driven by variances in wage rates



Note: in these and subsequent figures, "risk" is based on the HC's risk model which looks closely at the potential impact of the association.

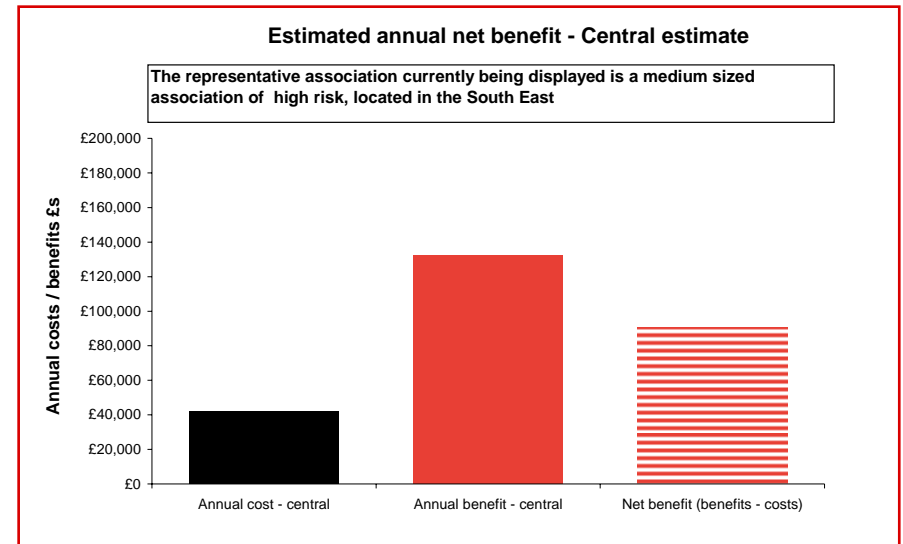
Net benefit varies more substantially by risk level of association



The charts illustrate that net benefit varies significantly by risk level of association. For example, the low risk association shown in the top left achieves an estimated annual net benefit of £102k.

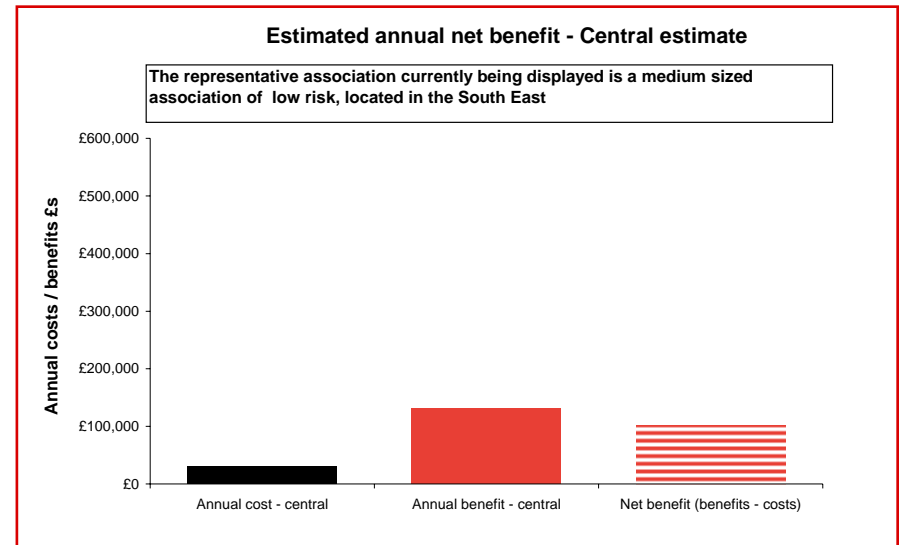
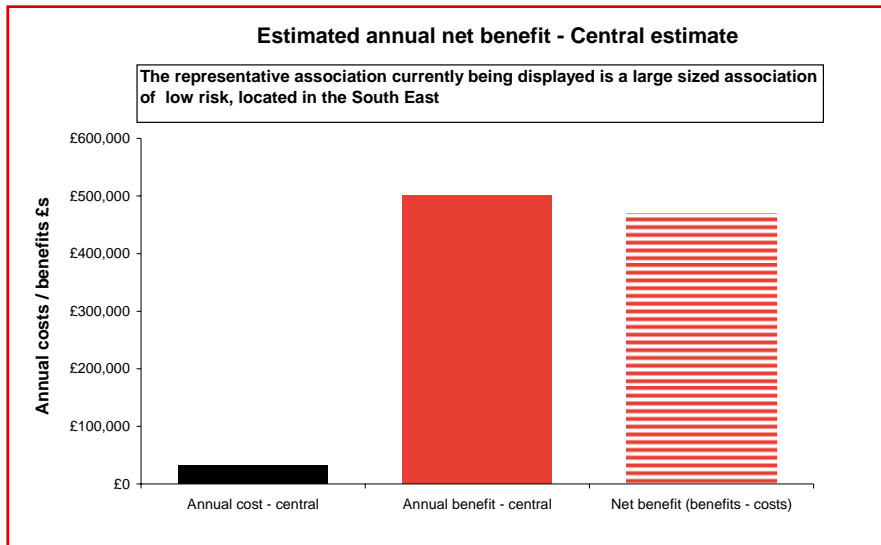
However, the high risk association shown in the bottom right achieves an estimated annual net benefit of £92k.

This variance by risk level reflects the fact that greater regulatory requirements are made of higher risk housing associations.



Note: in these and subsequent figures, “risk” is based on the HC’s risk model which looks closely at the potential impact of the association.

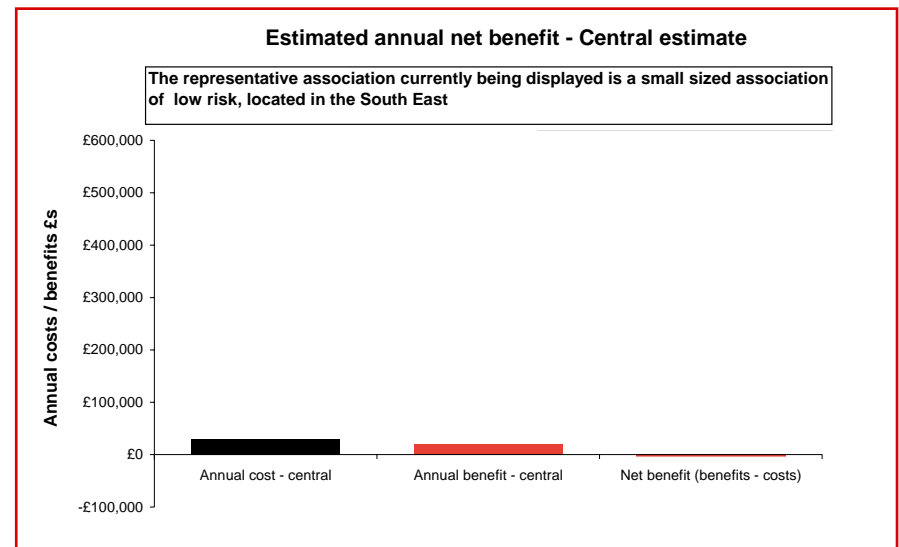
The greatest variance in net benefit is driven by the size of associations



The charts illustrate that net benefit varies a great deal by size of association. This is driven chiefly by the fact that large associations tend to borrow more than smaller ones, and thus achieve a greater quantifiable benefit from interest rate discounts. To a lesser degree, it is also driven by variance in wage rates.

The chart in the top left suggests that a large association can achieve a very high annual net benefit, in the region of £470k. The bottom right chart suggests that for some, small associations, annual net benefits could be marginal or slightly negative.

However, the charts exclude significant non quantifiable benefits outlined in this report. Were it possible to quantify these in some way, then net benefits could be higher than indicated for *all* types of association.



Note: in these and subsequent figures, “risk” is based on the HC’s risk model which looks closely at the potential impact of the association.

ANNEX F – QUANTITATIVE DATA REQUEST

Each selected association was asked to complete the following template for the 10-15 activities that take the most time to complete

REGULATORY REQUIREMENTS TEMPLATE FOR HOUSING ASSOCIATIONS

The purpose of this template is to obtain information that allows us to estimate the cost (to associations) of meeting regulatory requirements

For each document / task listed, please indicate:

1. How many times **per year** your association completes the document / task
2. The number of hours **per year** it takes to complete the document / task; and
3. The percentage split of time between chief exec, senior management etc for the task (e.g., in the example document, the chief executive provides 10% of the 200 hours required)

Please complete the template as indicated in the 'EXAMPLE DOCUMENT' row

REGULATORY DOCUMENT / REQUIREMENT	Number of times your association undertakes this task per year	NUMBER OF HOURS PER YEAR ASSIGNED TO TASK:	Of which % chief executive time	Of which % senior management time	Of which % middle management time	Of which % junior management time
EXAMPLE DOCUMENT	1	200	10%	30%	50%	10%
Adopting charitable status						
Allocations/nominations policy (link to RSR/CORE)						
Annual Efficiency Statement						
Anti-social behaviour policy						
Application to become a subsidiary/ merge						
ASB policy (link to RSR questions)						
Asbestos strategy						
Asset management strategy						
Audited accounts						
BACS payment details for receiving grant						
Best Value action plans / continuous improvement plans						
BME Diversity Action plan (link to RSR)						
Board and board member appraisal annually						
Board skills audit / review annually						
Budget/cashflow						
Business case for board payment						
Business continuity plan						
Business plan						
Change in Registry details and changes in structure (office, HA name, etc.)						
Change of rules/M&A						
Checking' regulation outputs (HCA, AVR)						
Client charter status						
Complaints policy and procedure						
Compliance with data protection						
Compliance with law (health and safety - e.g. gas, asbestos)						

Compliance with Local Authority requirements as Administering Authorities for Supporting People (arrangements driven by govt. policy)
Compliance with Scheme Development Standards (and sample checking through Compliance Audit)
Consent to disposal
CORE - report on lettings
Corporate structure review every 2-3 years
Engagement with Boards/EMT
EU procurement rules
External auditor's management letter

External validation of performance reporting systems (>2500) every three years
Financial standing orders
Framework of delegation reviewed annually
FV3 financial return
FV5 financial return
Governance documents - terms of ref.
Impact assessments (sample checking)
Information provision for review of programme/partnering delivery
Inspection action plans
Internal controls assurance statement
Internal standards and processes for development
Local Authority planning and Building Regulations requirements for development activity (inc. section 106)
Long term financial model
Management accounts
Membership of Independent Housing Ombudsmans Service
Notification of authorised signatories
Notification of board payment
Notification of change of address & website
Notification of change of auditors
Notification of change of bank
Notification of change of officers/senior staff
Notification of change of partnership arrangements
Notification of change of solicitors
Notification of change of unregistered subsidiaries
Organisation structure review every 2-3 years
Payment details
Performance against DHS targets (link to RSR)
Programme bids
Question changes largely related to policy issues
Registration and deregistration
Rent plans
Risk management strategy
RSR
Schedule 1 register
Self Assessment Compliance statement
Structure changes (ToE, mergers etc.)
Supporting people
Sustainable Development action plan
Sustainable development action plan
Tenant / resident involvement plans
Tenant / resident survey (2-3 years)
Transfers of Engagements (as and when)
Treasury strategy reviewed annually

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