Briefing Paper

Reinvigorating Right to Buy and One to One Replacement; Information for Local Authorities

March 2012

Introduction

The Right to Buy scheme was introduced in 1980 and gives qualifying social tenants the right to buy their home at a discount. The scheme is open to secure tenants of local authorities and non-charitable housing associations, and to those assured tenants of housing associations whose homes have transferred from a local authority as part of a housing stock transfer.

In '*Laying the Foundations: A Housing Strategy for England'*, the Government announced its intention to increase the caps on Right to Buy discounts to enable more tenants to achieve their ambition for home ownership. It also set out the Government's commitment to ensure that the receipts on every additional home sold under the Right to Buy are used to fund its replacement, on a one for one basis, with a new home for Affordable Rent. In December 2011, the Department for Communities and Local Government published a consultation setting out proposals for how this would be achieved and seeking views.

The Government has now announced its planned changes to the Right to Buy scheme, with details of how one for one replacement will work. Subject to Parliament, these changes will take effect from 2 April 2012.

Key points

- The government has increased the discount cap to £75,000 – a £25,000 increase on the cap proposed in the consultation document, allowing an even greater number of people to realise their aspiration of home ownership.
- The government states that, for the first time, every additional home sold under Right to Buy will be replaced by a new home for affordable rent, with receipts from sales recycled towards the cost of replacement.
- Local authorities will be able to retain the receipts for replacement housing – provided they can sign up to an agreement with Government that they will limit the use of the net Right to Buy receipts to 30% of the cost of the replacement homes.
- Councils will be able to deduct the necessary amount to cover the debt from the receipt but will not be required to use this part of the receipt to repay loans.
- For the first time, councils will be able to deduct a certain amount from the receipt for the cost of withdrawn applications. The government has increased that amount in response to evidence provided in the consultation, from 25% to 50%. Authorities will now be able to retain £2,850 in London and £1,300 in the rest of England to cover the costs of administration.
- The government has decided to retain the Buy Back provision, following representation from councils. Local authorities will be allowed to fund up to 50% of the cost of re-

purchasing a former council home, up to a maximum of 6.5% of any additional net receipts (i.e. receipts available to support one-for-one replacement).

- In response to consultation, the government has decided to: retain and extend the 'cost floor', from 10 years to 15 years; and continue to allow councils to apply for exemption from pooling arrangements (and therefore one for-one replacement) for Right to Buy receipts from new social homes built after 2008. Without these changes, the government recognises there could be a financial disincentive for local authorities to provide new affordable rented homes in future.

Tables of Key Changes (Below)

The government's table of key changes is replicated below:

Key Changes

Policy	Current Policy	From 2 April 2012
Discount Rates & Cap	Current discount rates are: • for houses: 35% of the property's value plus 1% for each year beyond the qualifying period up to a maximum of 60%; • for flats: 50% plus 2% for each year beyond the qualifying period up to a maximum of 70%. Tenants must have been public sector tenants for 5 years before they qualify for the Right to Buy In practice, most Right to Buy discounts are limited by caps. These currently range from £16,000 in most parts of London to £38,000 in parts of the South East (full details at Annex A).	We will increase the discount cap to **£75,000 across England**. Discount rates will not change and tenants will still need to have been public sector tenants for 5 years.
Use of Right to Buy Receipts	Subject to the deductions mentioned below, 75% of the receipts are paid to HM Treasury ("the poolable amount") and the remaining 25% are retained by local authorities.	After calculating transaction costs and compensating authorities for loss of income above what has been covered in the self-financing settlement, **HM Treasury and local authorities will receive the amounts they would have expected to receive**, had the policy on Right to Buy remained unchanged. (See Annex A of http://www.communities.gov.uk/documents/housing/pdf/2053578.pdf)
Administration Costs	For the purposes of calculating the poolable amount, local authorities may deduct the actual transaction costs of successful sales from Right to Buy receipts, but there is no allowance for costs relating to Right to Buy applications which do not result in a sale.	We will introduce flat rate allowances for London and the rest of England, set with regard to the 40th percentile of costs achieved by councils over the last 3 years, and – for the first time - with a 50% uplift for withdrawn applications. In our consultation, we proposed allowances of £2,360 for London and £1,070 for the rest of England. In light of consultation responses, we have decided that **allowances will be fixed at £2,850 for London and £1,300 for the rest of England.**
Preserved	As Housing Associations are	We propose a number of measures to

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Policy	Current Policy	From 2 April 2012
Right to Buy	independent organisations, we do not intend to mandate what they do with any receipts from Preserved Right to Buy sales – but our assumption is that receipts will be recycled into new affordable homes or other programmes with public benefits.	**incentivise Housing Associations to reinvest receipts:** • For providers who are not developing under the main Affordable Homes Programme, the Homes and Communities Agency will offer to broker working with an investment partnership. • Associations recycling their own receipts into new affordable housing will be prioritised when we consider any bids for Right to Buy receipts which have been returned to the centre. • We will also consider bids for additional freedoms and flexibilities for Housing Associations, where this would help ensure funds were recycled into new affordable housing
Buy Back	Councils may Buy Back former council properties and claim around 50% of the costs from their total Right to Buy receipts.	**We will retain the Buy Back facility, allowing councils to claim up to 50% of the value of each property** bought- **up to a total of 6.5% of the value of net Right to Buy receipts** (after administration costs, debt and assumed income). 6.5% is around the average level of Right to Buy receipts retained by local authorities for Buy Back over the last three years
Cost Floor	Section 131 of the Housing Act 1985 (the cost floor) limits the Right to Buy discount to ensure that the purchase price of the property does not fall below what has been spent on building, buying, repairing or maintaining it over a certain period of time (relevant expenditure).	We will increase the period of time the cost floor covers **from 10 to 15 years** for new homes subject to Right to Buy, bringing rules for councils into line with those for Housing Associations and protecting initial investment in the housing. **We will also retain the option for councils to apply for an exemption from pooling receipts for** new homes built in future.

Questions and Answers

What is the new discount?

The discount cap will be raised to £75,000 - quadrupling the discount across London and tripling it in much of the rest of the country. The government hopes that this will allow a greater number of social tenants to exercise their Right to Buy and meet their home ownership aspirations, support social mobility and help create and sustain mixed communities.

Why have the discount rates not changed in percentage terms, or regionally?

The government considers that the simplest and most immediate way of improving the Right to Buy offer is to raise the cap. While there is an argument for introducing a disparate approach across the country, the government wants to communicate a clear message to tenants of what is being offered. In practice, most tenants will still be limited by the discount rates according to their length of tenure.

Have the criteria for who can qualify for Right to Buy changed?

The Government say quite simply – 'No'. To qualify for Right to Buy or Preserved Right to Buy, tenants must have spent five years as public sector tenants.

How will one for one replacement be delivered?

Local authorities will be able to retain the receipts for replacement housing – provided they can sign up to an agreement with Government that they will limit the use of the net Right to Buy receipts to 30% of the cost of the replacement homes. This means that Councils must be able to fund the remaining 70% of the cost of new homes from loans supported by rents or from their own resources.

After discussion with local government, the Government has decided that receipts from Right to Buy sales will in future be applied as follows:

- The council may deduct certain costs, namely: an amount to cover the housing debt supportable from the income on the additional Right to Buy sales; transaction and administration costs; and an amount that reflects the income the council might reasonably have expected from Right to Buy sales prior to the new scheme;
- The council must also pay the Government an amount that reflects the income that the Treasury expected from Right to Buy sales prior to the new scheme;
- Once these costs are deducted, the remaining receipts (the 'net receipts') are available to fund (and must be applied to) replacement affordable rented homes.

The Government expects that, if it were to retain the net receipts from Right to Buy sales, it would be able to provide – at a national level - one-for-one replacement affordable rented homes, while restricting the contribution made from the net Right to Buy receipts to 30% of the cost of the replacement homes. Where a local authority is satisfied that it can match this rate (in other words, apply the remaining receipt to new affordable rented housing, while restricting the contribution made from the net Right to Buy receipts to 30% of the cost of the replacement homes), the Government will be prepared to enter into an Agreement that the authority may retain the remaining receipts.

The Government tell us that it will publish further details of the way in that this will operate shortly. Where authorities do not wish to enter into such an Agreement, the remaining receipt will be returned to the Department for Communities and Local Government, and re-distributed for new affordable rented housing by the Homes and Communities Agency (or, in London, the Greater London Authority).

Why has the 'local model with agreement' been adopted, rather than the national or purely local?

As the consultation paper made clear, the Government is seeking a solution that supports the localist agenda while achieving one-for-one replacement (for England as a whole) and ensuring value for money. Against these criteria, Ministers have concluded that the best option is a version of the 'Local Model with Agreement'. They considered that, off the other models: the 'Local' and 'Local with Direction' models do not give sufficient assurance of one-for-one replacement for England as a whole; and the 'National' model does not support the localist agenda.

How can you replace the additional homes sold on a one-for-one basis? Surely, the remaining receipt won't be large enough to cover the cost of a new home?

Drawing on evidence from the 2011-2015 Affordable Homes Programme – for that most agreements have now been signed – the government is clear that that it should be possible to fund new homes let at Affordable Rent levels, with no more than 30% of the cost of the new homes needing to come from the Right to Buy receipt.

As in the Affordable Homes Programme, the remainder of the cost will come from borrowing against the net rental income stream from the new property, and cross-subsidy from the landlord's own resources, including (in some cases) land.

So, for instance, for a new home costing £140,000 to build, the Right to Buy receipt would contribute up to £42,000. The Right to Buy receipt would not need to cover the full cost of the new home, just as Government grant only provides a minority of the funding for Affordable Rent in the Affordable Homes Programme.

The only way in that the funding for Right to Buy replacement differs from the main 'Affordable Rent' model is that cross-subsidy from converting re-lets of existing social rented homes to Affordable Rent will not be permitted. The 30% maximum contribution takes this into account (in the Affordable Homes Programme, government grant only contributes around 20% of the cost of the new homes).

'In our area, the remaining receipt will not be sufficient to fund one-for-one Replacement'. Must a council commit to delivering one-for-one replacement, to be allowed to retain the remaining receipt?

The Government tells us - No. As the Government set out in their consultation paper, it tells us that their aim is to deliver one-for-one replacement nationally. The Government says that it recognises that the remaining receipt will not be large enough to fund one-for-one replacement in some areas, and they are not requiring councils to do so.

If a council wishes to retain the remaining receipt, all it must do is spend that receipt on new affordable rented homes, making sure that no more than 30% of the cost of the new homes comes from the Right to Buy receipt. It can provide the new homes itself, or contract with another social housing provider.

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What do these changes mean for rural areas?

The Government proposes to retain the current restrictions on the resale of homes sold under the Right to Buy in rural areas. The Government go on to say that it understands the many concerns about the ability to replace homes sold under the Right to Buy in rural areas but the Government's decision to allow receipts to fund up to 30% of replacement costs will reflect any increased costs in the development of new affordable homes in rural areas.

What about the impact on housing in National Parks?

The Government is not minded to add National Parks to the list of exemptions to Right to Buy that would require changes to primary legislation. However, the Government tell us that it would welcome additional evidence of any impacts that the changes to Right to Buy have on affordable housing levels in National Parks.

What is being done to communicate the changes?

The Government is producing a set of materials to support local authorities in communicating the changes. This includes a template letter that local authorities can personalise and a new "summary guide" to the Right to Buy for prospective purchasers.

What is being done to prepare the financial sector for an increased uptake in Right to Buy applications?

The Government say that they are in dialogue with lenders and the Financial Services Authority to ensure that appropriate advice and information on mortgage products is available for prospective purchasers. The Government also say that they have issued a fact sheet to help ensure lenders are ready for implementation in April 2012 and that this is available to view at; http://www.communities.gov.uk/housing/homeownership/righttobuy/.

The Government is also working closely with the Money Advice Service, independent financial advisors and lenders to ensure that potential Right to Buy purchasers can access independent financial advice on their options.

What will the government do to prevent the system being abused or people being given the wrong advice?

The Government does not intend to make any legislative changes to the Right to Buy to require financial checks or limit purchase with family members at this time but, as set out in the consultation document, The Government says that it plans to keep the potential for any abuses under continual review.

What about transitional arrangements?

Where a tenant has already applied for the Right to Buy, but hasn't yet bought their home, they will automatically receive the increased discount. This means they will be able to take up the higher discount without making a new application to their landlord. And it will minimise additional administration for landlords.

What are the policy objectives and intentions of Right to Buy?

Reinvigorating Right to Buy is intended to boost home ownership for social tenants. The Government believe this will support social mobility policy objectives and help aspiration - around 80% of people aspire to homeownership. The government considers that one for one replacement of additional sales with affordable rented units will prevent Right to Buy sales depleting the affordable housing stock and would ensure their ability to meet housing need is not impaired. It has been estimated that there are around 1.9million households in housing need in England.

Using the Right to Buy sale receipts to invest in house building will also stimulate construction activity and support the economic recovery without the need to increase central Government borrowing.

What policy options have been considered, including any alternatives to regulation?

A number of Right to Buy policy options have been considered by the Government with an average discount of up to half the value of the property.

The key trade-offs are;
(i) boosting Right to Buy take-up and;
(ii) raising sufficient revenue per sale to be able to fund the replacement with an affordable rented unit and achieving value for money. The cash cap is important in this equation but is also designed to prevent excessive windfalls to social tenants whilst ensuring a generous offer.

For one for one replacement, the options essentially revolve around delivery and include:

- local delivery where receipts are left with the council for reinvestment locally;
- national delivery where receipts are allocated through a national programme administered by the Homes and Communities Agency (in London, this role would be undertaken by the Mayor) or;
- a combined approach

The chosen approach is option two (existing discount ranges with £75,000 cash cap) with a combined delivery model.

Context

To help more people realise their aspiration of home ownership, and to increase investment in further affordable housing, the Government intends to raise Right to Buy discounts to make them attractive to tenants across England. It is committed to replacing every additional home sold under the Right to Buy with a new home for affordable rent.

Under the Right to Buy legislation, council tenants (and tenants of housing associations who transferred from council landlords) have the right to buy their home at a discount. The policy has been a great success – in that since its introduction in 1980, almost 2 million households have exercised this right and can enjoy the benefits of homeownership including greater independence, security of owning a valuable asset and the right to change their home as they wish. This was recognised by the former Labour government:

"The Right to Buy was one of the most successful housing policies… because the policy enabled many households to become owner-occupiers who would not otherwise have been able to do so… It has been a positive influence in maintaining mixed communities in spatial terms.

"It has also provided a cheaper access point into owner-occupation for lower income employed households helping to sustain mixed communities as these properties are transferred into the market."

Source: (ODPM, Lessons from the past, challenges for the future for housing policy, January 2005)

However, the policy also depleted the housing stock so under the previous Labour Government discounts were reduced and the take-up of right to buy fell to an all-time low. Indeed, the former Labour government recognised that cuts to the discount rate would affect take up:

"The data suggests that those affected by the ceiling were somewhat more likely to withdraw from purchase. They were also more likely to face questions about the affordability of their purchase. Withdrawal was associated with the need to make larger average payments. These effects appear to be becoming more pronounced with time."

Source: (ODPM, The Impact of the 1999 Changes to the Right to Buy Discount, May 2003)

Evidence Box: The Right to Buy over time

On introduction in 1980, the discount was 33-50% (depending on length of tenancy) capped at £25,000. In 1984 the Government introduced the 'cost floor rule' for homes that had been built or renovated since March 1984 where more than £5,000 had been spent on the property. The 'cost floor rule' provides that the discount cannot reduce the purchase price below a certain level.

The discount range also changed to 32-60%. In 1987, the cap was increased to £35,000, and a higher discount of 44-70% was established for flats. The date for the cost floor was also changed from March 1984 to March 1974. In 1989, the cap increased from £35,000 to £50,000 and the cost floor rule changed to include buying the property and the effective time became eight years.

In 1999, the Government reduced the maximum discount, by introducing regional caps – from £22,000 in the North East to £38,000 in London. The effective time for the cost floor was also changed to 10 years. In 2003, the maximum discount was cut to just £16,000 in 41 local authority areas in London and the South East.

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The Housing Act 2004 then increased the qualification period for Right to Buy from two years to five years of tenancy (this had the effect of changing the discount range for houses from 35-60% and 50-70% for flats, both subject to cash caps) for those taking up a tenancy from 2005 onwards.

As a result of these changes, the average Right to Buy discount, as a percentage of the sale price, has fallen significantly over the last ten years; from a national average of 50% in 1998/99 to just 25% in 2010/114. In London, the fall has been even more pronounced with the average discount falling from 53% in 1998/99 to 13% in 2010/11.

The Government is now determined to reverse this decline and reinvigorate the policy to give a new generation the opportunity of homeownership. It has said that it will increase discounts to affordable levels and money from extra sales will be invested in paying down the existing housing debt and building new housing for affordable rent.

Currently, to qualify for Right to Buy or Preserved Right to Buy, tenants must have spent five years as public sector tenants. Once eligible, current discount rates are:

- for houses: 35% of the property's value plus 1% for each year beyond the qualifying period up to a maximum of 60%
- for flats: 50% plus 2% for each year beyond the qualifying period up to a maximum of 70%

In practice, most Right to Buy discounts are limited by caps set in secondary legislation. These currently range from £16,000 in most of London to £38,000 in the South East. The effect of the caps is that the average discount rate received by buyers in England is around 25% - ranging from 13% in London to 32% in the North West. The government considered that the simplest and most immediate way of improving the Right to Buy offer is to raise caps from their current low levels.

The option that Ministers have chosen is policy option 2 (maintain existing discount ranges with a £75,000 cash cap). This option was chosen because it was considered to best meet the policy objectives, in particular the potential to increase take up of Right to Buy whilst at the same time ensuring that receipts would be sufficient to enable one for one replacement with affordable rent properties. The £75,000 cash cap also limits the potential for large windfall gains that an 'uncapped' policy approach would lack. The 30 year Net Present Value under this approach is positive, and the policy option results in significant net economic benefits.

Currently, Right to Buy sales of council properties are running at around 2,600 a year. Once the council's costs relating to the sale have been covered, the council retains 25% of the remaining receipt from the sale, with the other 75% going to the Treasury. The Treasury's public expenditure forecasts include forecast Right to Buy receipts that are built into the Government's deficit reduction plan. Councils will also have made assumptions about the receipts they will receive from Right to Buy sales, on the basis of the current Right to Buy rules.

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The arrangements in the housing association sector are varied and depend on the local agreements made with transferring councils. In most cases, Preserved Right to Buy sale receipts are shared between the housing association and council, but in the case of early transfers, housing associations generally retain the full receipt. The element of the receipt retained by the housing association covers sales costs and compensates for lost rental income. This is important so that the sale has minimal impact on the housing association's business plan so it can continue to meet loan covenants.

The Government is committed to ensuring that every additional home sold under Right to Buy is replaced by a new home, and receipts from sales will be recycled towards the cost of replacement (and repayment of debt). The receipt needed to fund replacement will only be a proportion of the cost of a new home. This is because most of the funding for new affordable rented homes comes from borrowing by the provider against the future rental income stream; and, in many cases, cross subsidy from the landlord's own resources, including land.

As housing associations are independent organisations, the government does not wish or intend to mandate what they do with any receipts they retain. In practice, any surplus receipts (after costs and compensation for lost rental income) retained by housing associations are likely to be recycled to support new build and other public benefits. Where receipts are shared with councils, it is the government's expectation that housing associations will work with them to develop replacement homes.

The Government consulted on the best way to ensure delivery of the replacement homes with broadly three models:

- Local delivery – where receipts are left with the council for reinvestment locally
- National delivery – where receipts are allocated through a competitive national programme administered by the Homes and Communities Agency. In London, this role would be undertaken by the Mayor
- Combined approaches – either through directing how councils can use receipts or, where councils can show they are able to deliver one for one replacement and secure good value for money, allowing them to retain the receipts. Those who prefer not to lead on commissioning replacement homes or cannot meet the criteria could surrender receipts for distribution through a national programme.

Under the local delivery model, councils would generally be better placed to identify local needs and opportunities but less able to secure the wider competitive and distributional efficiencies that could be achieved through a national programme.

The chosen delivery model is a combined approach ('Local with Agreement') in that Local Authorities that have sold Right to Buy properties will have the opportunity to reinvest in replacement affordable rent properties subject to a maximum contribution from Right to Buy receipts. The government considers that this maximum contribution will ensure value for money whilst at the same time keeping in line with localist principles. Any Local Authorities that are unable or do not wish to use receipts for replacement will submit their surplus receipts to a national pool to which local authorities and Registered Providers could bid.

The Government tell us that they are committed to letting councils keep the proportion of the receipt needed to cover the housing debt associated with additional Right to Buy sales. This will ensure that the Right to Buy reforms do not have an impact on the viability of self-financing or independent social landlords.

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Future transfers of local authority properties to housing associations should not be affected as long as the discounts are applied consistently across both Right to Buy and Preserved Right to Buy that is our intention. This will provide tenants with the confidence that they will not be disadvantaged by transfer.

Problems under consideration

The Government wishes to help more people to realise their aspirations of home ownership. The Right to Buy programme has been immensely successful in helping to deliver this objective but sales have been in long term decline and minimal in recent years. Right to Buy sales across the Local Authority and Housing Association sectors combined amounted to fewer than 4,000 units in 2010/11. This is compared to a high in the early 1980s of over 160,000 sales per annum and a peak of over 80,000 sales per annum in the 2000s. Sales have fluctuated since the introduction of Right to Buy but the general trend has been downwards. This is likely to be a result of less generous discounts; increasing house prices; a general decline in the quality of the remaining stock as 'better' quality properties have been purchased; the changing socio-economic characteristics of social tenants; and, from 2007, adverse credit conditions.

The Government would like to see a significant increase in Right to Buy (and Preserved Right to Buy) sales in the coming years, allowing more social tenants to gain access to homeownership and meet their aspirations. The scale and rate of the increase in sales will depend not only on the generosity of the discount policy, but also fundamentally on economic and financial (mortgage market) conditions.

Meeting needs

Historically, the Right to Buy policy has not involved the replacement of sales with new social or affordable homes. This has been a key criticism of the policy in the past, given the rising levels of housing need and demand. Without one for one replacement of Right to Buy sales with affordable rented homes, the social and affordable housing stock has fallen. This is a problem because of the prevalence of housing need. It has been estimated that there are around 1.9million households in housing need in England Increasing the affordable housing supply remains an important way of meeting housing need and alleviating housing pressure, especially for the most vulnerable households.

Supporting economic growth

Construction output and jobs have suffered during the recession, more than other sectors, with housing output declining by around 40% from the peak; net additions were around 121,000 in the latest year compared to over 200,000 in 2007.

On the latest estimates from the Office for National Statistics, the sharp decline in construction accounted for a fifth of the 7.1% decline in Gross Domestic Product from peak to trough in the recession and house building is now at its lowest level since the 1920s. The government considers that the use of the Right to Buy receipts will provide a stimulus to construction and the wider economy that does not involve additional central Government borrowing.

Preserving right to buy in the housing association sector

Assured tenants of housing associations who were secure tenants of a local authority and have transferred with their homes as part of a stock transfer from the local authority to a housing association also have a right to buy – this is known as the Preserved Right to Buy. Eligibility, discount rates and caps applying to Right to Buy automatically apply to Preserved Right to Buy.

The number of tenants with Preserved Right to Buy is not known directly but, on the basis of a number of reasonable assumptions, the government estimates that about 620,000 tenants in the housing association sector are eligible.

Arrangements for distributing receipts from Preserved Right to Buy sales in the housing association sector are varied and depend on the local agreements made with transferring councils. In most cases, Preserved Right to Buy sale receipts are shared between the housing association and council but, for early transfers (pre 1991-92), housing associations generally retain the full receipt. Where receipts are shared, the portion retained by the association covers sales costs and compensates for lost rental income. This is important so that the sale has minimal impact on the association's business plan and it can continue to meet loan covenants.

Again, the Government admit that they do not have precise figures for the number of Preserved Right to Buy tenants in associations with sharing agreements but the government has estimated the figure at around 530,000 – about 85% of the tenants eligible for Preserved Right to Buy.

Arrangements for replacement

As housing associations are independent organisations, the government does not wish or intend to Mandate what associations do with any receipts they retain. In practice, any surplus receipts (after costs and compensation for lost rental income) retained by associations are likely to be recycled to support new build and other public benefits.

The Government estimates that around 70% of tenants (440,000) with Preserved Right to Buy are in associations with development programmes participating in the 2011-15 Affordable Homes Programmes.

For providers who are not developing under the main Affordable Homes Programme, the Government are considering whether the Homes and Communities Agency could incentivise reinvestment of proceeds in replacements by offering to broker working with an investment partnership delivering under the main programme to assist in development and identification of schemes. Where receipts are shared with councils, it is their expectation that associations will work with them to develop replacement homes.

Burdens on Housing Associations

There are three possible areas of impact upon housing associations:
- Cost of one for one replacement of housing purchased under the Right to Buy;
- Costs of administering sales; and
- Possible impact upon their business due to loss of assets and therefore borrowing capacity.

The Government has considered responses to the consultation on Reinvigorating the Right to Buy from individual Housing Associations and the National Housing Federation, the trade body.

The Government say that it expects the take-up of the Right to Buy and Preserved Right to Buy to be substantially higher than current levels, because of their proposals to increase average discounts on sales, and that the costs of administering sales (successful and withdrawn) will therefore rise correspondingly. Where associations retain all receipts from sales, they believe overall receipts will be sufficient to cover administration and transaction costs as well as any outstanding debt on properties sold.

Where associations share receipts with councils, under the terms of a sharing agreement, they can deduct an agreed allowance to cover sales costs from receipts and this will continue to be the case. Again estimates based on regional averages for costs, the Net Present Value of lost rental income and projected receipts show that receipts should more than cover administration costs and the Net Present Value of lost rental income.

Sharing agreements differ across different stock transfers, but there was very little concern in the sector about the impact of sales on their ability to raise debt or meet loan covenants – with responses to the consultation confirming assumptions about lost income and transaction and administration costs. Some Associations did raise the cost of abortive applications that may not be covered by their sharing agreements with local authorities but the impact is likely to be minimal and will vary according to the individual agreements negotiated by associations.

Having considered information held by the Tenant Services Authority the government does not believe any of the Housing Associations that hold stock where tenants have a Preserved Right to Buy meet the definition of a micro-business.

Impact on Housing Association capacity

Under a sharing agreement a Housing Association would typically keep the receipt calculated as the Net Present Value of the lost rental income on the home based on their original business plan (i.e. the attributable debt). This plan will have been drawn up at the point of transfer.

The debt profile in the business plan will generally be forecast to rise in the early years, as additional debt is taken on to pay for improvements. The level of debt will fall once past the point of peak debt as it is repaid, eventually falling below the starting debt position.

Where additional debt has been taken on for a home subsequently sold through Preserved Right to Buy, this will be reflected by an increase in the share of the receipt that the Housing Association retains. This will be most common where the stock transfer or improvement work takes place in the early years (say in the first five years). On the other hand, once debt begins to be repaid, the latest debt position will be less than the initial attributable debt (and receipt).

A further complication is that the business plans made by the Housing Associations themselves will be updated at least annually. These will take a revised, latest, view of the debt servicing capacity of the homes transferred to them. This debt servicing capacity is affected by future net rental stream that will typically grow and may be used to service new debt to fund affordable housing supply and other community benefits.

After a twenty year period this could be significantly more than the initial debt position at the point of transfer that is important for the more leveraged Housing Associations that are utilising that capacity more heavily.

According to the Tenant Services Authority, around 18% of the Preserved Right to Buy stock was transferred more than fifteen years ago, half (54%) was transferred to local authorities within the last ten years and nearly a quarter (23%) within the last five years. However, there are stark regional variations. For example, around 36% of the stock was transferred during the last five years in the North East (compared to the 23% national average).

Taken all these effects together, the usual profile is for debt to rise in the early years but to diminish over a thirty year period. It would be possible under Preserved Right to Buy sales, for the Housing Association's share of the sale receipt on Preserved Right to Buy sales to be less than the debt-servicing capacity they will have assumed in their latest business plan therefore reducing their overall capacity. However, as noted above, based on responses to the Consultation, there was very little concern in the sector about the impact of sales on their ability to raise debt or meet loan covenants.

The Tenant Services Authority has estimated that the average debt capacity for Housing Associations is around £19,000 per home under stock transfers and for the majority it is between £10,000 and £30,000.

Economic and social impacts

The HM Treasury Green Book suggests that policy appraisal should take into account the income levels of the beneficiaries of the policy. This is because, according to the theory of “diminishing marginal utility of consumption”, an individual’s well-being will vary according to his or her income, with policies aimed at lower income individuals having a greater impact than policies aimed at higher income households. Distributional analysis essentially allows the government to account for the economic benefits of making national household income more evenly distributed.

In theory, allowing social tenants to purchase a house under the Right to Buy policy has associated distributional benefits in that social tenants are on average less well off than the average household. Assuming that a social tenant exercising their Right to Buy is representative of the average social tenant (they might not be), the government has compared the equivalised income distribution of average social tenants compared to the national median average.

By combining the information on median equivalised incomes (by decile) and the distribution of social tenants (by these deciles), the Government will calculate the net distributional benefit of transferring £1 from the median household to a social tenant (or Right to Buy) household in each decile.

The distributional benefit of Right to Buy is calculated by applying this distributional weighting to the implicit subsidy associated with the Right to Buy unit. This subsidy is taken the difference between the thirty year Net Present Value of the thirty year social rents on the one hand, and the thirty year Net Present Value of the net costs associated with purchasing the property on the other (i.e. ongoing costs, such as mortgage payments and maintenance, associated with the property that are partly offset by the “value” of the asset at year thirty).

There are also distributional benefits that accrue to households renting the new affordable housing, because they are saving on rent by not having to rent private rented sector homes. This means that they can increase their consumption of other goods and services. This increase in consumption represents a distributional benefit given that affordable rent housing is, in general, allocated to lower income households.

Economic benefits (replacement) - Additional housing supply

The government considers that the economic benefit of additional housing supply (due to the one-for-one replacement requirement) can be captured through 'land value uplifts'. The land value uplift is the difference in land value between residential and non-residential use that proxies the benefit of building additional units in different locations that also captures the variance of the net value of new developments by location and will be greater in areas where additional housing is most needed. This benefit should in theory capture consumers' willingness to pay for housing services adjusted for the cost of using land for residential use.

The average potential uplift in each region is estimated using January 2009 Valuation Office Agency data that contains land values for both residential and non-residential usage. These values are assumed to grow in line with house price inflation.

However, not all replacement units will translate into additional housing supply. Some replacement units will be truly additional; but some replacement units will simply displace private supply. The 'additionality' of affordable housing is likely to change over time lending on local factors and current market conditions. A central assumption of 50% additionality is used. Given the current economic climate this is likely to be a conservative estimate; affordable housing is most likely to be additional:

- In economic downturns when house building activity is generally suppressed;
- When development is on infill sites and makes such sites more viable and levers in private development;
- When funding brings forward supply;
- When there are planning restrictions that mean that local authorities favour social housing;
- In conditions of low credit availability therefore creating funding difficulties for developers.

Implementation and Conclusions

Following consultation and based on the analysis of the evidence, Ministers have chosen option 2 that maintains the existing discount ranges but increases the cash cap substantially to £75,000 in all areas. This increase is large enough to stimulate increased Right to Buy sales and enable increased homeownership among social tenants, but at the same time ensure sufficient sales receipts to enable one for one replacement of every additional Right to Buy unit that is sold. The chosen delivery model is a combined approach that is based on Localist principles, but with safeguards to ensure value for money and to protect viability of one for one replacement.

The Government are implementing the change to the upper limits (caps) on Right to Buy discount entitlement through regulations made under section 131 of the Housing Act 1985. This will be secondary legislation requiring negative resolution. Changes to the Local Government Capital Finance regulations and the Housing Revenue Account determination will be necessary to allow for the correct treatment of receipts.

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The Local Government Capital Finance regulations also require a negative resolution in Parliament. The government has published details of the consultation and their response to it, including an explanation of the local with agreement delivery model when they lay the regulations in Parliament. The Government say they will continue to engage closely with councils, registered Providers and representative bodies to explain the system to them.

There will not be any change to the discount rates available on houses and flats; therefore no further action is required. The aim is to launch the enhanced discounts in April 2012 or shortly thereafter and the Government plan to make tenants aware of the changes to the discounts through a number of communication channels.

Government communications plans will also cover arrangements for ensuring that lenders and landlords are prepared for the likely increase in Right to Buy and Preserved Right to Buy applications.

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