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The metamorphosis of Social Housing

A CEO perspective

Forethought

Against a background of mounting economic pressures, Registered Providers of social housing are embracing a new spirit of entrepreneurship. We have conducted a series of interviews with social housing CEOs and discovered many are now asking the question: "what kind of organisation do we want to be?"

A new world

Until relatively recently, there were clear distinctions between the functions of the private and public sectors. Wealth creation was the preserve of the private sector, while the role of the public sector was to invest the wealth received through taxation into social infrastructure and services. The past years of austerity and changes in legislation have blurred the lines between the public and private sectors considerably. As social organisations have realised they can no longer depend solely on government grants and current income streams, they have been forced to adapt and find new ways of generating revenue.

The result is that many social organisations are morphing into more commercial organisations. This transition is as evident among Registered Providers (RPs) of social housing as it is in local government or the voluntary sector.

Generating income from non-core activities

RPs are now accessing income in a wide variety of ways, from buying and selling land and other assets, to offering a range of services other than housing; providing social care, or even operating leisure centres. In our social housing report, *New world of risk: embracing the unknown*[1], we revealed that 76% of RPs had introduced new services beyond their core role as a housing provider.

Many housing association CEOs are now faced with the philosophical question of 'what are we for, and what kind of organisation do we want to be?' These CEOs are also having to re-evaluate how their organisations are run.

There is a spectrum of organisations from those moving to full commercialisation, to those focussing purely on the traditional housing association role.

Commercialisation requires new skillsets and new mind-sets, including a new way of looking at risk.

There is a growing awareness that being entrepreneurial requires an understanding of the level of risk you are prepared to accept, and the consequences of not exploiting commercial opportunities.

As one CEO put it, **"risk is about good things not happening, as well as bad things happening".**

RPs now view commercialisation as a way of building resilience within their organisation.

A director of a housing association in the North-West of England told a Housing People forum[2] last year: **"Housing associations set up commercial arms because they want to generate a surplus and to buffer against risk. It is becoming more of a gamble to keep your eggs in one basket."**

According to a report by Social Housing[3] magazine, RPs are generating an estimated £2.3 billion from diversified activities, such as agricultural lettings, building homes for market rent, and leisure centre management.

The report reveals that some groups are generating up to half their income from non-core activities, with one association bringing in the majority (53%) of its income in this way, driven largely by market sale and shared ownership sales.

While commercialisation is on the increase there is an acknowledgment that employees are drawn to the ethical purpose of social housing, and an awareness that a balance needs to be struck between an organisation's social aims and its commercial interests.

1. http://newsandviews.zurich.co.uk/wp-content/uploads/2015/03/New-world-of-risk-embracing-the-unknown.pdf
2. http://www.housing-people.co.uk/wp-content/uploads/2016/03/Diversification-and-Commercialisation-Training-and-Development.pdf
3. http://www.socialhousing.co.uk/free-preview-social-housings-diversification-report/7005588.article

Why is the housing sector changing?

Accessing finance and managing the impact of welfare reforms are among the key challenges Registered Providers face.

"Government has a view that housing associations must be inefficient as they don't have shareholders."

"The world of boards is changing massively. They are all moving to becoming much more commercial."

"The sector is splitting and polarising in terms of scale, mission and culture."

"We need to understand that not everything will work. Sooner or later we will get something wrong."

"Risk is about good things not happening, as well as bad things happening."

"Employees are looking for us to have more risk appetite, more entrepreneurship."

"We need to scale back from offering a Rolls-Royce service."

"People are drawn to the ethical purpose of social housing."

"Housing associations are unnecessarily competitive with each other."

The economic factors that have led housing associations to explore new ways of generating income are wide-ranging.

One of the most significant was the decision in 2015 by the then-Chancellor, George Osborne, to cut social housing rents by 1% a year from 2016 to 2020. On the back of several years of austerity and welfare reforms, this rent reduction took the whole sector by surprise and had a prominent impact on many RPs.

According to rating agency Moody's[4], the cut to social housing rents has meant that housing associations are having to maintain higher operating margins in order to protect their credit worthiness. One CEO we spoke to told us **"the cut has taken £600m out of our organisation"**.

RPs have also had to adjust to the fact that since the roll-out of Universal Credit, they no longer have the income stream they used to enjoy when they received tenants' housing benefit directly. According to PHHS Ltd[5], an average housing association with around 5,000 properties and a £20m annual rent roll will now have £12m in rent 'at risk' each year as a result of the introduction of Universal Credit. **"The rent arrears of those on Universal Credit are typically double the amount of those on housing benefit,"** said one CEO.

"Given a choice of paying your rent and feeding your children, you feed your children," remarked another housing leader, who said that as well as losing the certainty of receiving rental income, they had also been affected by the increase in administrative costs since the introduction of Universal Credit.

In *New world of risk: embracing the unknown*[6], nearly half (47%) of RPs said Universal Credit was one of the biggest strategic risks facing the sector over the next five years. The only risk that scored more highly was funding (51%).

Another of the big challenges relating to funding is that RPs are finding it harder to borrow money from banks at the interest rates they used to be offered.

"There used to be covenants in place that allowed housing associations to get loans at incredibly low interest rates," says one of our respondents.

"This is one of the reasons mergers and acquisitions are such a problem for housing associations. If they change their structure, their bank can break the covenant and renegotiate the loan at a much higher interest rate."

One CEO, whose organisation is making £20m in interest payments, said they faced a constant struggle to avoid having to renegotiate loans.

4. http://www.socialhousing.co.uk/moodys-moves-sector-outlook-from-stable-to-negative/7010932.article
5. http://www.phhsl.co.uk/uploads/7/1/5/0/7150053/can_social_housing_afford_not_to_become_commercial.pdf
6. http://newsandviews.zurich.co.uk/wp-content/uploads/2015/03/New-world-of-risk-embracing-the-unknown.pdf

Commercialisation is risky

While housing associations have traditionally been risk-averse, they are now having to accept the reality that their appetite will change as they look to make the most of commercial opportunities.

If you were to trawl through the jobs section of a newspaper from 20 or 30 years ago, it is unlikely you would have stumbled across an advert for a Director of Transformation at a housing association.

And yet one of the CEOs we interviewed has made just such an appointment recently, in order to help manage the transition to a more commercially minded organisation.

Other leaders we spoke to described the significant changes that have been made to the make-up of their boards, aimed at ensuring their organisations have the right blend of business acumen and expertise in areas such as commercial management.

One explained: **"Our employees are looking for us to have more risk appetite and entrepreneurship."**

Some RPs told us this cultural change has proved a challenge. Housing associations have traditionally been quite risk-averse. For a long time they were entirely dependent on government funding and attractive bank loans.

For many years, some were quite conventional in what they did, and how they were staffed, with many RPs being made up almost entirely of ex-local government employees who were not necessarily commercially minded.

That is changing now. The boards of two housing associations we spoke to have been completely transformed in the last couple of years. They have brought in leaders who are much more innovative and entrepreneurially minded.

One CEO told us: **"We cannot be so risk averse – we have to accept that things will go wrong."**

Housing associations are going into new ventures, like social care and educational attainment, and they are transforming their business models to make them less costly.

While today's RPs may be willing to consider changing their business appetite in order to exploit commercial opportunities, there are also risk considerations.

For example, some housing associations have diversified into offering services that include providing expertise or advice, such as employment training or money advice.

Many of these professions are heavily regulated by professional bodies, and there will probably be a requirement that practitioners in these areas hold a minimum level of Professional Indemnity cover to protect themselves against potential negligence claims.

> "Our employees are looking for us to have more risk appetite and entrepreneurship."

No room for a Rolls-Royce service

As a consequence of this change in approach, there has been a re-evaluation of the way RPs manage their housing stock, both in terms of the building of homes and the way refurbishments are carried out. One CEO, for example, admitted their organisation now **"builds to the lowest specifications allowed by building regulations."**

For repairs and refurbishments, there was a consensus that the old ways have to change, with one housing leader reflecting that their organisation has now cut back to providing a much more pragmatic service. As another CEO put it: **"We need to scale back from offering a Rolls-Royce service."**

Where RPs would once have committed to replacing kitchens at a set point in their life cycle, regardless of their state of disrepair, they are now more likely to consider a "mini-modernisation" to avoid the expense of a total refurbishment.

There was plenty of discussion about the different approaches to building new properties.

While some RPs are clear that **"adding value is about delivering more houses"**, others have stopped building altogether.

One CEO commented that: **"It shouldn't just be about maxing-out development. It should be about providing a range of development."**

There was a clear sense of polarisation of views between different RPs on this subject area.

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Collaboration, place-shaping and the future

While housing associations have traditionally had close working relationships with local authorities, many are now also working collaboratively with a variety of other agencies, from NHS bodies to schools, colleges and universities.

This is part of a pattern of collaboration aimed at delivering improved services for local communities – place-shaping – which has in part been enabled by recent moves towards greater devolution. One interviewee is working closely with the Greater Manchester Combined Authority on a range of social issues that it considers could have an impact on its customers – including health, employment and skills training.

PWC recognised in *The housing association of 2020: Distinctive by design*[7] that not all collaborations will be easy or necessarily successful, but the chances of success can be maximised through a careful exploration of shared outcomes, defining goals and pooling appropriate resources to deliver with the support of good governance.

Funding for such social initiatives remains a challenge

Every area of funding today is focussed on economic development.

As one respondent put it: **“If you don’t develop your economy, you don’t get the funding.**

“There are always winners and losers, however, and if you are attracting businesses and attracting investment, then other parts of the country are missing out.”

CEOs understand they are operating in a very competitive world and they recognise the importance of becoming more resilient.

One respondent talked about the importance of building resilience to cope with the **“headwinds of economic uncertainty”.**

7. http://www.pwc.co.uk/industries/government-public-sector/local-government/insights/distinctive-by-design.html

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It will be extremely intriguing to see where housing associations go. It will be fascinating to see where the pendulum stops.”

What does the future hold?

From a traditional base the social housing sector is diversifying and polarising almost beyond recognition.

While commercialisation and entrepreneurship are now the norm for many, the social purpose of providing decent, affordable housing has not been forgotten. Housing associations may have become more commercially minded, but as one interviewee said: **“We are not bottom-line obsessed”**.

Another commented that their ethical standards are such that they often walk away from potential business opportunities.

As PWC reported in *The housing association of 2020: Distinctive by design*[8], housing associations need to re-establish clarity on the nature of their business and how they balance the need for good operational finance performance, successful commercial projects, the right level of customer service, and **delivering on social value**.

In the next three to five years, it will be extremely intriguing to see where housing associations go. Will they continue to become more commercial, or will they, at some point, say “this is not what we are meant to be?” It will be fascinating to see where the pendulum stops.

Zurich Municipal would like to thank the participating social housing chief executives for making this report possible.

8. http://www.pwc.co.uk/industries/government-public-sector/local-government/insights/distinctive-by-design.html

Contact us

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