



Housing associations and private sector leasing

Overview

This Sector Study is based on research undertaken by HACAS Chapman Hendy for the Housing Corporation, to review the profile and impact of Private Sector Leasing (PSL) arrangements on housing associations (HAs). It examines how HAs involved in PSL are operating and managing their programmes and reviewing their own performance. In addition it seeks to establish the principal risks associated with HA PSL schemes and how these are being addressed by the organisations concerned. Finally, it aims to highlight issues and actions for HAs arising from the research.

Private Sector Leasing holds considerable risks for HAs. They should therefore only embark on it if they have evaluated those risks and established staff and systems to handle its special features. It is worth noting that even some larger HAs, with considerable knowledge and expertise in the area, said they had experienced some difficulties with their PSL operations.

Background

Between 1978 and 1992 the number of statutorily homeless households living in temporary accommodation in England increased from below 2,000 to 65,000. Local authorities (LAs), particularly those in high demand areas, were housing many families in bed and breakfast accommodation, often in cramped and unsatisfactory conditions, due to a lack of available permanent social housing. In an effort to reduce the numbers housed in this way, LAs began to develop schemes to increase the level of appropriate temporary housing available and many looked to the private rented sector to help them achieve this.

Private Sector Leasing (PSL) involved LAs leasing privately owned rental property — usually on very favourable financial terms for the private landlord — to use as temporary accommodation for homeless households. Although leases were held by the LA, HAs were often involved in the acquisition and/or management of PSL stock.

HAs began directly leasing privately owned properties — known as Housing Association Leasing (HAL) — when new Government restrictions and regulations limited subsidies and restricted lease length for LA PSL schemes. HAs were not affected by the new restrictions and were therefore able to continue to use the private sector where many LAs could not.

The Housing Corporation reinforced the role of HAs in private sector leasing when the Housing Associations as Managing Agents (HAMA) funding programme was launched in 1991. Under HAMA the tenancy agreement was between the landlord and the tenant with the HA acting as managing agent, in much the same way as in the private rented sector. LAs were able to offer additional financial support to HAs, for example by paying nomination fees (a



contribution towards management costs), reinstatement costs (to return a property to its original condition at the end of a tenancy), or underwriting void periods (e.g. guaranteeing 52 weeks of rent to the owner).

However, shortly after HAMA was launched, a decline in the levels of homeless households accepted for permanent housing by LAs led to a reduction in the number of households living in temporary accommodation. Demand by LAs for new temporary housing units reduced and many LAs withdrew their support for HAMA schemes. Despite this, some HAs continued to use the private rented sector as a source of new units, with many developing their use beyond those in the greatest housing need to other client groups, without the financial support of LAs.

The use of privately owned units for social housing has continued and the Housing Corporation is aware of a number of HAs currently operating PSL-type schemes. The operation and management of these schemes is very different to traditional housing management and exposes the HA to far greater risks than normal general needs. As the sector continues to diversify it is possible that other HAs are considering becoming involved in PSL without a proper or full assessment of the risks and issues this may present.

The research highlighted in this Sector Study involved 11 HAs based in and around London known to be involved in PSL schemes. All were asked to complete a survey covering a range of issues relating to the operation and management of PSL schemes, in particular:

- the nature and volume of PSL
- the principal risks associated with PSL
- workload peculiarities and staffing
- methods for appraising new PSL schemes
- legal arrangements and lease models
- key indicators of performance for PSL operations.

The HAs that responded were responsible for around 11,500 PSL units in 23 LAs in and around London.

The nature of PSL by associations

The majority of HAs were operating Housing Association Lease (HAL) schemes. Here HAs enter into a lease, generally of 3/5 years, with a private landlord. A market rent is payable for the term of the lease and a reinstatement clause ensures that at the end of the lease, the property is returned in a similar condition as at inception, allowing for reasonable wear and tear. Rent charged by the HA (to an HB eligible tenant nominated by the LA) covers the amount payable to the landlord and any liabilities falling due under the terms of the lease. Under this arrangement the LA has no legal relationship with the private landlord and the risks of the scheme fall entirely on the HA.

Some HAs have been deterred from operating PSL schemes in some LAs due to the extremely high levels of rents private landlords can command, although incentives can sometimes be offered.

Staffing and workload peculiarities

PSL schemes require a different style of management than normal general needs housing, staffing therefore differs between the two types of operation. Some of the differences are:

- Housing Officer numbers per unit for PSL schemes are greater than for general needs, around 1:125 compared to 1:250. However levels still fall some way short of the supported housing ratio of around 1:30. (HAs with large PSL holdings operated a dedicated team, while those with only a few hundred units tended to absorb scheme management within their general needs function).
- PSL scheme management requires more of a credit control mentality to keep cash flow under close scrutiny, than the traditional housing management approach required for general needs. It is very staff intensive and realistically requires an investment in specialised IT accounting systems to obtain specific management information.

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PRINCIPAL RISKS ASSOCIATED WITH LEASING SCHEMES

Most of the risks identified by HAs impacted directly on the financial viability of PSL schemes. Key to this is that PSL schemes charge market rents which exacerbates the financial effect of periods where rents are not paid. The impact of this is felt most strongly in popular areas where private rents are high. The principal risks for HAs in PSL schemes were:

- **Housing Benefit**
- **void management**
- **maintenance and repairs costs**
- **safety**
- **lease management**
- **public relations**

1) Housing Benefit (HB) administration can cause particular problems for HAs in PSL schemes. Rents are payable to the private landlord at market levels, so delayed HB approval/payment can lead to acute cashflow problems for the HA. The performance of HB private contractors coupled with the introduction of a strict verification framework increases pressure on HAs and impacts on their ability to effectively manage rent collection. As rents include an allowance for voids and bad debts, prolonged delays in rent payment by an LA can impact on other areas of HA financial management. In addition, management fees payable to the HA are often included in the rent so HB delays can mean the HA is unable to collect other amounts due to them.

Suggestions for minimising problems with HB administration included:

- Developing good working relationships with LAs, through liaison and contact officers at an operational and strategic level.
- Ensuring staff have a clear understanding of HB administration within individual LAs.
- Negotiating fast track HB approvals with LAs.
- Negotiating an early termination clause to the lease in the event of HB or other difficulties arising.
- Negotiating with the LA to underwrite the cost of delays in HB administration.
- Keeping the management fee separate from the rent payable.

2) Management of voids is critical for similar reasons as above, primarily that the HA is contractually obliged to pay market rent to the landlord irrespective of whether the property is occupied. Poor performance in the management of void properties can therefore cause severe financial problems for the HA.

Suggestions for reducing problems concerning voids included:

- Concentrating schemes in areas where the HA has a good relationship with the LA.
- Agreeing standards of performance with the LA at the outset.
- Negotiating a penalty clause with the LA if they fail to nominate.

3) Maintenance/furniture costs and the cost of **repairs at handback** can expose the HA to high repair costs. The temporary nature of PSL accommodation can lead to high tenant turnover and thus increase damage and wear and tear to the property. At lease end a property is returned in a condition allowing for reasonable wear and tear, rather than as it was taken into management. However this is open to interpretation (and potential dispute) by both the HA and the landlord.

Suggestions for reducing potential repairs and maintenance costs included:

- Ensuring potential repair costs are factored in to scheme appraisals.
- Sharing maintenance responsibilities for the property with the landlord.
- Ensuring appropriate systems and staff are in place to recover amounts due from the landlord (or to adjust rent payable if necessary).
- Ensuring details of arrangements regarding the condition of the property at handback are clearly spelled out in the lease.
- Negotiating an appropriate clause to protect the HA against action by the LA which leads to a large number of relets, whereby the LA bears some or all of the cost of repairs.

4) Safety of the property is primarily the responsibility of the landlord, however should the appropriate certificates not be forthcoming, for example a certificate of gas safety, it is up to the HA to obtain them and reclaim costs from the landlord. It is therefore important that the HA has proper mechanisms and staff in place to ensure prompt recovery of costs from the landlord.

5) Management of leases is important to ensure that overall leases expire in a steady and planned manner. Failure to monitor lease ends properly may lead to the HA having to acquire replacement units in unfavourable market conditions. The volatile nature of leasing programmes means that staffing arrangements need to be flexible to allow for growth and shrinkage in the size of the PSL programme.

Suggestions for effectively managing leases included:

- Entering into leases of only 3 or 6 years, thus ensuring the HA remains responsive to changing supply or demand.
- Working within a programme of planned acquisitions to ensure leases expire in a steady and programmed way.

6) Public relations are important, particularly when an HA could receive unfavourable press coverage. Handback disputes with landlords over the condition of their property, the general quality of the management of the stock and nuisance issues are all common and could expose the HA to bad PR. Nuisance issues are particularly common when leases are taken in properties which also include owner occupiers, who will not always welcome homeless families and who sometimes seize the opportunity to campaign. Sensitive management of issues relating to PSL is essential to minimise damage to the HA as a whole.

In view of the risks outlined above, it is important that HAs consider the issue of the size of their PSL commitment within their overall risk assessment process. An HA's PSL operation should be in proportion to their other activities so core business is not destabilised by financial or other difficulties experienced in the PSL programme.

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- Larger HAs have a dedicated finance team for their leasing operation, providing a range of services such as interpreting HAs responsibilities under lease and management agreements, debt recovery, cashflow monitoring and chasing for management fees and rents.
- Some HAs have specialist posts involved in their PSL schemes, examples included HB Co-ordinator/Liaison Officer, Court Liaison Officer, Landlord Recoveries Officer, Gas certification Officer, Handback Manager and Acquisition Manager.
- Staffing needs to be more flexible, usually involving temporary staff, to allow for ups and downs in the numbers of leasing units in management at any one time.

The nature of PSL operations means that those involved in management face different pressures than with normal general needs housing management, these include:

- The often transitional nature of the accommodation may result in tenants having moved on ahead of their HB claim being assessed. As mentioned earlier, this means that management of PSL requires a different, more financially focused approach and a dimension of reactivity not usually found in general needs management.
- Voids are consistently high due to constant tenant turnover and late notification of rehousing by LAs.
- Problems arise due to the uncertain immigration status of some tenants and delays in receiving notice of determination from the LA and Home Office. Further problems may arise from the withdrawal of HB entitlement, Social Services intervention, sublets and abandonment following unfavourable determinations. Workload peculiarities can arise from housing asylum seekers and as far as possible, nomination agreements should be worded to deal with the specific issues arising from this.

Methods for appraising new PSL schemes

Methods of appraising a scheme generally focus on ways of determining financial feasibility. Broadly HAs were using 3 methods of appraisal.

Financial feasibility based on cost involves (in order):

An evaluation of scheme costs, an analysis of the LA requirement, an assessment of the management input and service level agreement and finally a calculation of the financial elements. This leads to an overall assessment of scheme feasibility.

Financial feasibility based on a minimum return

using a modified turnover, it is calculated (after all service costs, overheads, bad debts and voids), as: Rent receivable plus fees, less rent payable to the landlord. A secondary measure involves using net present value calculations to test the impact of cost inflation.

Financial feasibility together with an appraisal of key risks.

This is the most comprehensive appraisal method and takes account of operational, political, commercial and financial considerations. The method includes an evaluation of:

- the payment method of the management fee
- the HB verification framework
- Rent Officer interference with rents
- the potential effects on rents of housing working families
- penalties for failure to acquire sufficient units
- court delays in gaining possession orders
- a particular LA's form of lease
- relet turnover.

The final step is to evaluate the business case.

Legal arrangements and lease models

As mentioned above, the most common lease model used in PSL is the HAL model, where the risk is entirely on the HA. The shift from the early days of PSL, when the LA took most of the risk, appears to be irreversible. Competition between HAs and pressure on LAs to minimise costs have brought about and maintain the current situation.

There is no agreement on a standard form of contract for PSL, but HAs should ensure that the LA nomination agreement:

- clearly states the financial responsibilities of LA and HA
- ensures the management/nomination fee is paid independently of HB.

HAs should only extend the landlord's lease by a maximum of 6 months and this should:

- clearly define events which trigger termination of the lease
- state the dilapidation liability of the HA/LA and the landlord.

Tenants are given an Assured Shorthold Tenancy Agreement. This should clearly set out the legal relationship between the HA and the tenant and detail the notice procedure.

Key indicators of performance

Key performance indicators and management information HAs were using to track business performance cover items such as:

- numbers of units
- reactive maintenance spend
- relet void works
- first let turnaround time
- relet turnaround time
- rent arrears
- voids and bad debts
- scheme profitability
- cash collection targets.

Of these, occupancy levels and cash collection were considered to be of great importance. In addition, measures such as the number of units/weeks in management (actual versus budget) coupled with more traditional PIs, were being used.

Conclusions

Overall PSL schemes hold considerable risks for HAs, who may not properly understand the different nature of private leasing compared to standard general needs housing. HAs involved in PSL indicate that a clear view of the unique problems associated with the business and a full evaluation of the risks involved is essential.

Competent management requires a dedicated team of skilled staff who are trained to handle the legal, financial and commercial issues involved. Specialist staff with an understanding of the sensitivities of the operational environment are also useful to liaise with LAs and tenants.

Tailored IT systems providing management information specifically for PSL schemes, will ensure that situations where viability is threatened can be picked up and acted upon promptly.

Finally, tight financial controls, robust performance management information and a more commercial approach to running operations go some way to addressing the risks involved and avoiding the problems some HAs have previously encountered.

Additional information

The research this Sector Study is based on was conducted by HACAS Chapman Hendy Ltd, United House, North Road, London N7 9DP. The Sector Study was prepared by Siobhan McHugh at the Housing Corporation.

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