Costing Cost Rental

SUSTAINABLE FINANCE TO MEET HOUSING DEMAND

SOCIAL JUSTICE IRELAND

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Proposal

Increased housing supply is necessary to support the thousands of families currently in precarious private rented and temporary emergency homeless accommodation. Both NESC and NERI have previously proposed a European cost rental system however, it is our understanding that these systems have not been implemented as they relied on the capacity of the entity concerned to access off-balance sheet funding.

Social Justice Ireland supports the NESC and NERI models and proposes an augmented structure to take advantage of public and private investment, operating within the parameters of the European System of Accounts for off-balance sheet delivery.

Introduction

Cost renting is defined as 'all rental housing, irrespective of ownership, the rents of which cover only actual incurred costs of a stock of dwellings' (Kemeny, 1995). The cost rent is calculated to take account of the cost of land, finance, construction and management of the dwellings. Any subsidy available on the supply side would be factored into the cost-rent calculation, and demand-side subsidies (e.g. Housing Assistance Payment) would be available to eligible, low-income households.

A small number of pilot projects have been approved in recent months, however in an era of double-digit rent inflation, exponential increases in homelessness, and high social housing waiting lists, there is a need to scale-up the provision of cost-rent housing and ensure financing capacity for sustainable delivery over time. This would not only have the direct effect of providing low-cost accommodation, but of slowing the pace of inflation of both rent and house prices in the medium- to long-term.

What would Cost Rental look like for the tenant?

While rents may initially be higher than current differential rent schemes, the cost to the tenant of cost-rent would be subsidised according to an affordability assessment (similar to current subsidies available to tenants in private rented accommodation), to ensure that tenants are only paying what they can afford. Alternatively, cost-rents could be subsidised in the early years when cost-rent is higher, with the subsidy phased out over time as rents decrease. This would be a more effective use of this Government expenditure than linking a Housing Assistance Payment to private market rent fluctuations. Tenants would have security of tenure and long-term sustainability. Their rents should decrease over the lifetime of the tenancy, so long-term tenants would not face private rent increases in their old age when they are less likely to be able to absorb the cost.

The cost of supply would be spread out over 25-30 years and would include not only construction, financing and development costs, but management and maintenance to ensure homes are kept in a habitable condition. *Social Justice Ireland* would also propose that costs associated with quality inspections also be factored in so as to ensure that all cost rental properties are inspected regularly and maintenance work carried out within the earliest timeframe.

What would Cost Rental look like for the State?

Government has both land and money to invest in the provision of this model to provide the economies of scale needed to keep rents affordable. The possibility of off-balance sheet and mixed-finance mechanisms also exist which would broaden the finance base, making it less susceptible to shocks in any one sector.

Cost-rent would be linked to the costs associated with the provision of the property. Tenant's payments would be subsidised based on their affordability, reviewed periodically to allow households to take up employment without fear of eviction and allowing the State to re-direct some of its current subsidies to those who can least afford their rent.

At the end of a tenancy, when the tenant dies or moves out, the property could be factored back into the overall stock of the provider and leveraged to raise further finance to increase supply, or, should Ireland reach a point where supply is no longer an issue, could remain at the lower amount, as in other countries in which this model of public housing is working effectively.

Social Justice Ireland would not be in favour of any rent-indexing to markets, even at a proportion of the market rent, as has been suggested elsewhere. The intention of this proposal is to provide sustainable, high-quality, affordable homes, using some of the capital currently available to Government and without significantly increasing Government debt.

Expenditure – Present and Possible

Current Expenditure on Housing and Homelessness – payments to the Private Sector

Local Authority Financial Reports for 2017 indicate that Local Authority expenditure on the provision of homeless accommodation reached almost €150 million for the year (€148,980,401), 76 per cent of which (€112,770,163) was paid to providers of emergency accommodation.

According to the 2017 Local Authority Budgets[1], an estimated €228 million was allocated as expenditure on the Housing Assistance Payment (HAP) and a further €254 million was allocated in respect of the Rental Accommodation Scheme. In 2016, the latest date for which data is currently available, €275 million was paid in respect of Rent Supplement (RS). While some households were transferred from RS to HAP in the intervening period, with the increase in private market rent during that time, it is likely that the expenditure in respect of RS did not decrease significantly during that time.

This amounts to over €869 million in current expenditure to the private sector for the provision of rent subsidies and emergency accommodation[2].

From temporary fixes to long-term solutions

The Government's latest National Development Plan[3] committed to spending €4.2 billion for the provision of 40,000 new social homes. It is unclear from the text if this provision is to be made from increasing supply or increased investment in the private sector, however it is concerning to note that within the same period, current expenditure on rent subsidies and emergency accommodation will amount to just under €3.5 billion (at 2017 rates of expenditure), while making no provision for the increase in need.

Budget 2018 allocated €1.9 billion to social housing, an increase of 46 per cent on the previous year, €1.14 billion (60 per cent) of which was intended to fund the construction of 4,969 homes and the acquisition of a further 900. Were a similar increase allocated this year, that would raise the total housing allocation to €2.77 billion. A capital investment of 60 per cent of that amount in cost rental would see €1.66 billion put towards the delivery of this long-term accommodation for low-income households.

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[1] http://www.housing.gov.ie/sites/default/files/publications/files/final_local_authority_budget_publication_2017.pdf

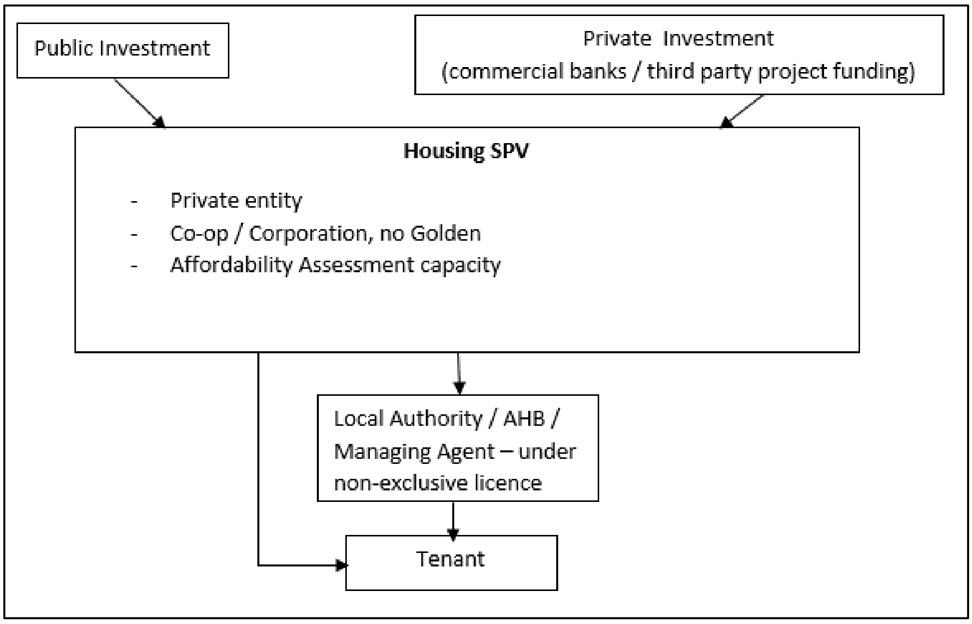
[2] This figure does not include SCHEP which provides funding for longer term leases.

[3] http://www.per.gov.ie/en/national-development-plan-2018-2027/

Proposed Model and Finance Structure

The National Economic & Social Council (NESC, 2014) and NERI (Healy & Goldrick-Kelly, 2017) have both proposed a European model of cost rental which could attract both public and private investment, sitting within an over-arching 'housing body' which, with an appropriate governance structure, could form the basis for delivery of sufficient scale. *Social Justice Ireland* proposes a similar model which optimises the finance opportunities available to attract both public and private investment (Figure 1) to deliver the necessary scale of housing.

Figure 1: *Social Justice Ireland* Proposed Model



In our proposed model (Figure 1), the Housing SPV is the landlord who can enter into a licencing arrangement with the local authorities or Approved Housing Bodies (AHBs) as well as third party managing agents to manage cost rental properties and the day to day needs of tenants. The Housing SPV would be established as a joint venture, special purpose vehicle, with public and private investment, with a Governing Board, but no golden share vesting in any one party. The constitution of the Governing Board would be reflective of the respective public / private investment. The Chairperson of the Governing Board would have a deciding vote, and would be nominated for election by the members of the Governing Board[4]. Voting rights will carry pari passu with the value of the investment, subject to the consideration by Government of housing legislation similar to that recently introduced in the UK[5].

Cost rents would be set based on the cost of provision of the properties – site costs, construction, financing costs, administration, maintenance and inspection. The Housing SPV would establish the affordability parameters[6] and conduct affordability assessments. In the event of a tenant requiring a cost rent subsidy, a modified Housing Assistance Payment could be explored which would decrease in line with the cost rent.

[4] But would not have to be from within the current members of the Governing Board.
[5] See below.
[6] Models exist within the public and private sector which may be instructive – Central Bank mortgage lending criteria, Local Authority mortgage lending criteria, means-testing benefits and Legal Aid etc. None of these would provide the exact right model, but could inform the basis for one.

Off-balance Sheet – Classification of Approved Housing Bodies

Any discussion of Cost Rental, particularly at the scale required to produce the necessary level of affordable public housing will ultimately lead to cost and its impact on the general government balance sheet.

On the 2nd March 2018, the European Commission, EUROSTAT, issued a letter to Ireland's Central Statistics Office (CSO) confirming classification of Approved Housing Bodies (AHBs) within the General Government Sector (EUROSTAT, 2018). In doing so, and in line with the assessment of the CSO, they considered:

- The relationship between Government and AHBs
- Control of AHBs
- Key Features of funding available to AHBs
- The non-market nature of AHBs

In order, therefore, to explore the possibility of financing cost rental outside of the General Government Sector, it will be necessary to explore these considerations within the funding model proposed.

The relationship between Government and the Housing SPV

In its consideration of the relationship between Government and AHBs, the CSO looked at the autonomy of AHBs with particular focus on the criteria for an institutional unit as set out in the European System of Accounts, ESA 2010 2.12 (Eurostat, 2013). ESA 2010 2.12 defines an institutional unit as:

> an institutional unit is an economic entity characterised by decision-making autonomy in the exercise of its principal function. A resident unit is regarded as constituting an institutional unit in the economic territory where it has its centre of predominant interest if it has decision-making autonomy and either keeps a complete set of accounts, or is able to compile a complete set of accounts.

In order to maintain its autonomy, 2.12 continues, the institutional unit must be:

(a) entitled to own goods and assets in its own right; it will be able to exchange the ownership of goods and assets in transactions with other institutional units;
(b) able to take economic decisions and engage in economic activities for which it is responsible and accountable at law;
(c) able to incur liabilities on its own behalf, to take on other obligations or further commitments and to enter into contracts; and
(d) able to draw up a complete set of accounts, comprised of accounting records covering all its transactions carried out during the accounting period, as well as a balance sheet of assets and liabilities.

Accordingly, to meet the criteria for an autonomous institutional unit, the Housing SPV must not only have the above characteristics contained within its constitutional documents, but must not enter into any contractual or other arrangement with any party, including the State, which may undermine these characteristics. Legislation specifically limiting Government control, such as that enacted in the UK, would be helpful in this regard.

Control of AHBs

The CSO considered the funding schemes and characteristics of AHBs in line with the control criteria of ESA 2012 20.15. This provision refers to the classification of non-profit institutions (NPIs) to the general government sector. Section 20.13 provides that NPIs that are non-market producers and are controlled by government are units of the general government sector. Provision 20.15 determines control of a NPI as

> the ability to determine the general policy or programme of the NPI. Public intervention in the form of general regulations applicable to all units working in the same activity is irrelevant when deciding whether the government holds control over an individual unit. To determine whether a NPI is controlled by the government, the following five indicators of control should be considered:
>
> (a) the appointment of officers;
> (b) other provisions of the enabling instrument, such as the obligations in the statute of the NPI;
> (c) contractual agreements;
> (d) degree of financing;
> (e) risk exposure.
>
> A single indicator can be sufficient to establish control. However, if a NPI that is mainly financed by government remains able to determine its policy or programme to a significant extent along the lines mentioned in the other indicators, then it would not be considered as being controlled by government. In most cases, a number of indicators will collectively indicate control. A decision based on these indicators will be judgmental in nature.

The Appointment of Officers

The CSO reviewed this provision in respect of AHBs and could find no evidence of Government influence in the appointment of their officers. In the cost rental model proposed by *Social Justice Ireland*, officers of the Housing SPV would be appointed independently in accordance with its constitutional documents.

Other provisions of the enabling instrument

The Housing SPV would have a comprehensive set of constitutional documents providing for the independent appointment of key personnel with fully-delegated authority to manage the day to day operations in the best interests of the company.

Contractual Agreements, Degree of Financing and Risk Exposure

The contractual agreements entered into between AHBs and Government provide the basis for the capital funding of the AHBs. The provisions of the Capital Loan Subsidy Scheme (CLSS), Capital Advance Scheme (CAS), Capital Advance Leasing Facility (CALF) and Payment and Availability Agreement (P&A) afford Government decision-making power over

- the selection of tenants by a relevant local authority (CLSS, CAS, CALF and P&A)
- the formula for setting rents or rent levels (CLSS, CAS)
- the design and construction of housing units (CLSS, CAS)

In both CLSS and CAS, the level of financing provided brings the expenditure on construction by AHBs in scope of public procurement policy.

In the model proposed by *Social Justice Ireland,* the Housing SPV would establish affordability assessment and tenant selection criteria; rents are based on the cost of housing provision; design and construction would be a matter for the Housing SPV. As in the case of most cost-rent jurisdictions, it would be anticipated that the majority of funding would be raised privately, thereby remaining outside the scope of public procurement policy.

Policy Context and Classification of Assets

The CSO found that policy instruments concerning social housing indicated the Government's intention of a central role for the AHB sector in social housing provision. Conditions for becoming an AHB and availing of Government funding are set out in section 6 of the Housing (Miscellaneous Provisions) Act 1992 wherein the form and governance required for voluntary housing bodies to hold AHB status, and therefore to access funding, is prescribed. It also found that AHBs are a key mechanism for Government and Local Authorities to implement their housing strategy, and refers to AHBs as agents of Local Authorities, concluding that, at a minimum, the provisions of MGDD 2016 I.2.4.5.1 paragraph 57 should apply to the housing assets held by AHBs and that these assets and associated transactions can be said to represent '*investing in fixed assets for public policy needs'* and should be re-routed to the Government sector.

Paragraph 57 of MGDD 2016 I.2.4.5.1 refers

> The objective of this sub-section is to specify under which conditions some transactions should be subject to rerouting via government accounts. Examples of such transactions are:
>
> - loans granted to some units at the request of government;
> - subscription to bonds, notes or bills in the context of public policies;
> - trading market instruments for prices stabilisation purposes;
> - acquiring shares of public corporations on behalf of government;
> - holding public corporations under a privatisation process;
> - granting subsidies or investment grants to some units in the context of public policies;
> - managing financial assets on behalf of government units;
> - taking part in lease operations with government units;
> - providing hedging of market risks on behalf of government;
> - investing in fixed assets for public policy needs;
> - purchasing goods or services in order to support some corporations;
> - collecting compulsory contributions in the context of special arrangements set up by government;
> - receiving fees for services which have the features of taxes in national accounts (for instance for public radio/TV); etc.

Paragraph 56 of the MGDD 2016 sets the context for this reclassification, which may apply where Government is '*at the origin of the transactions in the context of policies aiming to influence the behaviour of economic agencies and second, because government has under its control public units which can be entrusted to perform some tasks*' and goes on to state that this may also apply in cases of private entities which may contribute to the implementation of specific government policies or interventions. Within the footnote to this paragraph is the provision that this reclassification would apply only if the activity was a minor part of the activity of the units *'if they would be deemed to have no autonomy of decision (see e.g. the cases of captive financial institutions controlled by government)*'.

As discussed earlier, the model proposed by *Social Justice Ireland* would have autonomous decision-making power, including the right to delegate the operational management of the organisation to independently appointed officers and staff.

The funding instruments themselves were found to be indicators of control, given the onerous nature of the conditions re tenant selection, restrictions on type of housing to be build and role of Government in setting the rent (that is, differential rent under CLSS and P&A, and guidance on rent setting in CAS). There are further indicators of control found in the conditions imposed on an AHB to retain its AHB status, particularly that the housing assets of AHB must be used for social housing.

'Social housing supports' is defined in section 19(2) of the Housing (Miscellaneous Provisions) Act, 2009 as [emphasis and parenthesis added]:

(a) dwellings provided by a housing authority under the Housing Acts 1966 to 2009; or
(b) provided under Part V of the Planning and Development Act 2000, other than affordable housing;
(c) dwellings provided by an approved body;
(d) the sale of a dwelling under Part 3 (*tenant purchase schemes*);
(e) entering into and maintaining rental accommodation availability agreements;
(f) the provision of sites for caravans referred to in section 13 of the Act of 1988 and any accommodation provided to travellers under the Housing (Traveller accommodation) Act 1998;
(g) the provision of sites for building purposes under section 57 of the Principal Act.

Only category (g) of the above definition may be relevant to the cost rental model proposed should the State invest by way of land provision, rather than capital expenditure, however section 57 of the Housing Act 1966 refers to land provided by the State for the purpose of the Act itself, and therefore it is arguable that land provided by the State for housing other than that provided pursuant to that Act would not come within that definition.

By imposing such onerous pre-conditions on AHBs, the CSO posits that the Government is the de facto landlord, with the AHB merely an agent acting on its behalf. The funding models pose further difficulty in that they expose the State to significant risk, as at the end of 2015, the level of private funding accessed by AHBs was less than 1 per cent. Given that the majority of AHB funding is sourced from Government, and that funding has conditions attached, this funding was found by the CSO to have the effect of closely aligning AHBs with Government policy on social housing.

Further, in accordance with MGDD 2016 I.2.3, paragraph 15(c) provides that where such contractual arrangements make up the '*main, if not total, part of the activity of the NPI, it is clear that government would be able to influence the general policy of the NPI. However, control should be assessed if the approval of government would be required for exiting from contracts with government.*' While AHBs can repay their funding commitments in full and effectively exit their contracts, it would be unlikely to function as an AHB into the future and the tenancies would either then be transferred to the local authority directly or another AHB. The CSO considered this provision and found that, this being the case, the exit of any one or more AHBs from the sector would not alter the landscape of social housing provision, as the tenants' position vis a vis the local authority or other AHB would not appreciably change.

As stated, in the model proposed by *Social Justice Ireland*, the Housing SPV would effectively control the construction specifications and tenancies, and have its own governing Board and management team. Should the State invest land instead of capital funding, the transferring instrument could be drafted in such a way as to clearly disapply the provisions of section 57 of the Housing Act 1966, for the avoidance of any doubt.

The funding model would also be such that at least 50 per cent would be sourced from non-Government sources.

The CSO also assessed each individual AHB in relation to the extent that the funding schemes dominate the financing of the AHB. Where CAS and CLSS funding were the dominant sources, the CSO found it necessary to classify the AHB within the general government sector. Where the funding represented only a minority of the funding of the AHB, or where there was a mix of activities such that housing was not the principal activity, only the housing activity was rerouted to the general government sector in accordance with MGDD 2016 I.2.4.5.1, paragraph 57, discussed earlier.

Market / Non-Market Nature

The degree of government control, government influence on rent-setting and the provisions of the constitutional documents establishing AHBs led the CSO to find that the quantitative market / non market test did not apply to AHBs whose rents are predominantly set under CAS and CLSS (differential rent). While rents under P&A agreements may be more economically significant, there was insufficient levels within the AHB sector for them to be considered market operators.

The quantitative market / non-market test is set out in MGDD 2016 I.2.4.3, paragraph 30, which provides that at least 50 per cent of 'production costs' must be covered by 'sales' (as defined in paragraph 31). However in respect of 'new public enterprises', paragraph 36 provides:

> In case of new public enterprises the market / non-market test may be difficult to apply immediately due to the lack of data and/or because of a progressive gearing up[7]. The classification should be therefore based on a realistic business plan[8] and special attention should be given to check whether the unit is likely to become a market producer in a short period of time. In some cases, where the new unit is a merger of previous units, the results of previous periods can be used as an indication of future performance.

As cost rental is predicated on covering its production costs through rents received, and the model proposed by *Social Justice Ireland* provides for the Housing Assistance Payment subsidy, on a phased-down basis in line with cost rent reductions over time (linked to the value of the output, and to which any producer of the same activity would be entitled) it should be possible to produce a realistic business plan which supports a classification of market entity.

Need for Clear Direction – European System of Accounts

In Ireland's current economic landscape, financing housing on/off-balance sheet is less of an issue than it may have been during the recession. The Central Bank has announced that average household wealth is higher now than during the 'boom'. We now have the capacity to increase our tax take and

[7] This is notably the case for new units which need in a first step significant capital expenditure and which will start to sell its services only after the completion of the works.

[8] The term "realistic" should refer to several notions, such as the availability and quality of the data used, the plausibility of the hypotheses used in forecast, the competence of the authors, etc. However, when it turns out after some years that the business plan has not given the expected results, the ex-ante sector classification of the entity should be revised.

expand our tax base to secure the necessary funding for infrastructural development. However, while Ireland's balance sheet is in relatively good shape, the CSO estimates that the government sector had a negative net worth of €44 billion in 2016, before taking account of public pension liabilities. Further, given the extent of the housing crisis, there is room for both on- and off- balance sheet investment in this key area.

During the most recent recession, Ireland reduced capital expenditure as part of a suite of 'austerity measures'. This lack of investment decimated the construction sector, which saw a decline of almost half in both persons engaged in the sector (-47.5 per cent) and Gross Value Added (-48.9 per cent) between 2008 and 2014. Annual turnover in that period decreased by 62.7 per cent (Central Statistics Office, 2016). It is against this background that the need to secure future funding to ensure the delivery of essential infrastructure is evident. Off-balance sheet financing provides this security by ensuring long-term sustainability should Ireland's economic circumstances change.

The complexities of interpreting the European System of Accounts 2010 (ESA) and the accompanying Manual on Government Deficit and Debt 2016 (MGDD) are clear from the correspondence between the CSO and Eurostat. A conservative application leads to all housing stock held by Approved Housing Bodies, and any transactions relating to this stock, to be classified as part of the general government sector, however it is unlikely that these instruments were intended to be so restrictive as to limit a country's ability to provide basic necessities for its inhabitants.

In 2017, the UK Government passed the Regulation of Social Housing (Influence of Local Authorities) (England) Regulations 2017. These short Regulations reduced the influence of local authority officers on the boards of private registered providers (PRPs), specifically voting rights, to no more than 24 per cent. In reviewing the classification of PRPs in light of these Regulations, the Office for National Statistics (ONS) concluded that 'local authority and central government influence in combination with the existence of nomination agreements does not constitute public sector control. Therefore English PRPs have been reclassified from Public Non-Financial Corporations (S.11001) to Private Non-Financial Corporations (S.11002).' from the date on which the Regulations came into effect. This ONS classification decision reversed an earlier decision from 2015 which reclassified PRPs in England from the private corporate sector to the public corporate sector. However, even within the 2015 classification, they were not classified as part of the general government sector as they were deemed to charge 'economically significant prices'. The 2017 Regulations demonstrate that it is possible for Governments to enact statutory instruments which limit their own control, thereby enabling local authorities (and by extension in an Irish context, housing bodies or a dedicated housing entity) to generate finance and build homes. While Government control was only one indicator referred to by the CSO, and confirmed by Eurostat, that housing provision should be placed within the general government sector, it is a significant factor.

At a time of unprecedented levels of homelessness, high social housing numbers, and an increasingly aging population, it is incumbent on Government to consider mechanisms to provide housing at scale, within the parameters of the ESA and MGDD, and to engage at European level to review how these instruments may best balance fiscal prudence with provision of essential infrastructure for all its inhabitants.

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