

The Cave Review
Of Social Housing Regulation

*Independent review of
regulation of social housing*

A call for evidence

On 5th May 2006 the responsibilities of the Office of the Deputy Prime Minister (ODPM) transferred to the Department for Communities and Local Government

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Call for Evidence

Purpose of the review

1. This review has been commissioned to consider the range of options available for the regulation of social housing activities. The objectives of the review are set out in the terms of reference available at www.communities.gov.uk/cavereview
2. The current regulatory system for social housing is administered by the Housing Corporation and is centred on Registered Social Landlords (RSLs, which we also refer to as housing associations). RSLs are also subject to an inspection regime carried out by the Audit Commission, which is also responsible for the inspection of social housing provided by Local Authority and Arms Length Management Organisations (ALMOs).
3. There are a number of options available for modernising RSL regulation and some of these may have implications for the regulation of social housing providers more generally. The call for evidence is drafted to reflect our primary concern to address the need to modernise regulation of those bodies currently regulated by the Housing Corporation, within the context of a mixed economy of provision which has existed since section 27a of the Housing Act 2004 permitted the payment of grant to non-RSL providers. However, we will want to consider the extent to which this debate generates questions and options which encompass all social housing providers, including local authorities and ALMOs, and we would welcome contributions to this effect.
4. This call for evidence expresses provisional opinions on some relevant matters, but we have not reached firm conclusions on any issue, and respondents are welcome to contest any of the views expressed herein.
5. At the heart of our review is the objective of finding the regulatory option which will best meet the two principal requirements, which the review team has provisionally identified, which originate from the needs of the two principal 'customers' of social housing:
 - to secure for social housing residents high quality, value for money services, which offer them, and the communities of which they are part, effective mechanisms to ensure that their landlords meet the obligations to provide those services, and to ensure that they have an effective voice in the design and delivery of those services;
 - to secure for taxpayers proper assurance that the resources that government makes available for social housing go to those landlords who can make best use of them to provide good quality homes and services, in ways which meet government objectives.
6. Social housing does not operate detached from other governance structures, so in achieving the above objectives, regulation should also ensure that there is innovation and cooperation with local government and other agencies that contribute to the objectives of promoting sustainable communities and reduction of social and financial exclusion.

7. The services to which we refer comprise both basic 'landlord services' and additional services ('landlord plus' services). We are not assuming that the same regulatory regime need apply to all services.

Our timetable

8. Our remit is to carry out a review which will report to the Secretary of State in Spring 2007.
9. The first stage of this review is to invite submissions of evidence which indicate how a regulatory framework might be designed and implemented, or adapted from its present statutory footing, to best meet the principal requirements which we have set out above.
10. In order to allow the review team to properly consider this evidence, the deadline for submissions is **16 February 2007**. The review team will also organise a number of workshops for interested parties.

Why regulate?

11. Social housing is a scarce resource. Government has therefore adopted policies which seek to ration access to social housing – although the detail of the mechanisms adopted by landlords to do so varies, they do so according to broadly comparable criteria based around housing need. The rents which landlords charge to tenants are for the most part below those that prevail in the open market. A majority of tenants rely on financial assistance from government to meet all or part of their rent. Tenants have limited power to make choices about which landlord they rent their home from, or to switch to another landlord if they are dissatisfied, although the extent to which this is a factor depends upon the levels of demand in different areas. Each of these attributes applies, in some degree, to the home ownership options which housing associations also offer.
12. As a result the marketplace for social housing does not function effectively, and there is a need for some form of regulatory intervention to ensure that social housing providers use resources as efficiently and effectively as possible to meet residents' needs and government objectives in relation to social housing.
13. The review team will explore the extent to which residents themselves can play a part in the regulatory process, whether as individual consumers, or in more collective forms. We think this is intrinsically desirable – it places consumer and community expectations at the heart of the regulatory regime, and offers residents more say in the recognition of good performance and the application of sanctions for poor performance. To this extent, the review will consider the balance of regulatory levers and incentives which residents can apply directly in a bottom-up manner, and those which are applied top-down by a regulatory body.

14. The incentives for social housing providers to deliver high quality services as efficiently as possible are currently relatively weak, compared with other sectors. The absence of a profit-making incentive for providers is one factor in this, given that all social housing is currently managed by public sector or not-for-profit bodies. In addition, as noted above, there is currently an undersupply of social housing and prospective tenants therefore have little or no choice in respect of their provider – they must take a social housing tenancy as and when it becomes available. Once someone is a tenant, there is very limited opportunity to move home or switch provider if they are dissatisfied, so the landlord does not need to improve services to prevent them from going elsewhere. Further, since rent levels are constrained by the rent restructuring formula which is set by the Communities and Local Government and secured in the housing association sector by the Housing Corporation, there are limited incentives in relation to rents which could operate to ensure service improvements.
15. One way to redress the weakness of market mechanisms is for a regulatory framework to strengthen incentives to provide efficient, high quality services. Under the Housing Corporation's current system RSLs are unlikely to suffer meaningful sanctions as a result of underperformance except in cases of clear failure. Additionally, except in cases of clear failure, the grant system as currently applied does not take into account management performance as a significant factor when taking decisions about allocations.
16. At present there is competition between RSLs and (since the Housing Act 2004) non-RSLs for grant for the provision of new social housing. However, since new supply adds some 30,000 social rented units per annum as against 2 million units of existing housing association stock, and a further 2 million homes managed by local authorities or Arms Length Management Organisations (ALMOs), the benefits of this competition are limited in relation to the overall social housing stock. There are two approaches that might be followed to promote improvement in the management of the existing stock:
 - Greater competitiveness in the sector, in order to incentivise landlords to provide improved services, might be introduced by opening the market to a wider range of organisations (for example by allowing a wider range of organisations, including profit-making bodies, to register with the regulator as providers of social housing) or allowing a restructuring of existing providers;
 - Another approach could be to establish a framework which compares and publishes information about the comparative costs and quality of service provision, and links such performance with a balanced distribution of gains from operating more efficiently among landlords, tenants and government.
17. The present system administered by the Housing Corporation regulates the governance and financial viability as well as the quality of services provided by housing associations. In respect of financial viability, it is clear that government does not underwrite housing associations. It is crucial to our thinking that any acceptable options will preserve both their independent status and the fact that their borrowing is not classified as public expenditure.

18. The housing association sector has attracted over £30bn of private sector funds. The availability of those funds, and their price, has been determined by the sector's approach to financial management and the comfort provided by a vigilant regulatory regime.
19. The Government seeks to minimise the level of public sector finance provided to housing associations for new supply of social housing, and to optimise the grant rate paid. The continuing flow of private finance into the social housing sector is therefore essential to enable the Government to meet its targets for new social housing supply. It is important that any new system provides continuing assurance to lenders of the financial and organisational health of the sector, whilst being clear that there are no financial guarantees. It is for competitive lending institutions to price the risk of the housing associations to whom they provide funds.
20. The review team is interested in examining evidence about the scope for increasing the resources available to the sector, and the impact on the cost of capital or scale of debt funding of any changes in the regulatory framework which introduce a different set of incentives to expand provision and increase efficiency, but which might alter the allocation of risks.
21. Social housing providers undertake a wide range of activities which are complementary to their core landlord activities, and which are essential to the sustainability and cohesion of the communities where they work. Widening the scope of a uniform regulatory regime to cover the full range of such activities is problematic. We invite views on whether this broader neighbourhood and community role is properly subject to regulation, or whether it is preferable to ensure that there are effective alternative routes (including contractual ones) for associations to participate in, and be held accountable for, their work with neighbourhoods and communities. The review team is interested in understanding how best to balance the tension between focusing the regulatory regime on delivering better quality, more efficient landlord services, and the desirability of encouraging innovation and enterprise in managing resources to make the social housing system work more effectively in achieving the broader objectives of social and financial inclusion which the review led by John Hills is considering.
22. The purpose of the review is to find the best option for regulation, recognising that it is unlikely ever to be a perfect substitute for an efficiently functioning market. Accordingly, our consideration of the options will have full regard to the principles of good regulation set out by the Better Regulation Commission, and the principles of inspection and enforcement set out in the report of the Hampton Review. This can be found at: www.hm-treasury.gov.uk/budget/budget_05/press_notices/bud_bud05_presshampton.cfm

Options for consideration

(please note that this is not intended to be an exhaustive list)

a) Retaining or reforming the Housing Corporation's present framework

23. The regulatory framework, as it is currently established for RSLs, has broadly fulfilled its purpose over more than three decades. It has been adapted to cope with substantial changes in the nature of the sector. The review will consider the extent to which it meets the objectives for a regulatory system for RSLs, bearing in mind that it was **not** designed:
 - explicitly to afford landlords the powers, duties and incentives to operate efficiently in providing good quality services;
 - to embed the views of residents into its operation;
 - to cope with a market where the range of possible providers do not meet the statutory requirements for registration; or
 - with specific concern for public expenditure definitions.
24. One alternative is to seek to update the current regulatory framework as it is defined in statute, but to retain the same basic approach. There are a number of possibilities, but the most significant elements we want to consider are whether there are specific benefits to residents or to the taxpayer/government of removing the requirement for regulated social housing providers either to be non-profit-distributing organisations or the requirement which prevents unregistered organisations from owning subsidiaries which are RSLs.
25. Current statutory provisions already permit unregistered organisations to apply for and receive public subsidy to develop new homes, and to manage the services provided to tenants of those homes. However, this is done under a different set of contractual regulatory requirements – thereby creating a twin-track regulatory system for different types of organisation, even though they are engaged in the same activity.
26. The housing association sector manages over 2,000,000 homes. Of 1792 associations, the substantial majority each owns less than 250 homes (cumulatively less than 3% of the sector's stock) and does not undertake a material amount of new development relative to that undertaken by larger housing associations. There may be a case for some degree of separate consideration of this group of associations. Whilst they play a critical role, the degree of distinction from larger associations and group structures, particularly their limited involvement in development, and the limited regulatory engagement to which they are currently subject, may suggest that a different approach is justified.

27. A further alternative may be to separate distinct regulatory tasks more explicitly within the current statutory framework. ‘Constitutional’ regulation may be required as a distinct function for organisations which are currently registered with the Housing Corporation, but is less central to the function of ensuring delivery of high quality housing services, which has to be applied across all housing providers, regardless of their constitutional form. Similarly, the range of bodies that would be subject to regulation, related to the use of grant to develop new social housing, is also different, being both smaller in number, and not exclusively consisting of housing associations.
28. A more explicit categorisation and separation of areas of regulation might enable a clearer definition of the required outcomes, the incentives and sanctions which facilitate effective delivery of those outcomes, and, for regulated bodies, greater clarity about the scope of the regulation to which they are subject.

b) Licensing/contract based approaches to regulation

29. The present regulatory framework is designed to regulate organisations rather than services or activities. A framework, which was concerned only with establishing the continuing competence and effectiveness of an organisation to deliver specified types of service to residents, would be concerned primarily with the regulation of that activity; those services might then be regulated through an accreditation or licensing approach.
30. The detailed design of such a system could take a number of forms, but the fundamental element would be the switch to a set of regulatory requirements which would be more contractual in form, subject to periodic review, and terminable where there is default by a service provider. As it is an activity-focused approach, separate approvals or agreements could be developed to separate out development, ownership and management functions and responsibilities. Views are sought on the feasibility of the separation of these functions.
31. One issue to consider is what the impact would be of terminating a provider’s contract or licence. This would appear to necessitate the involuntary transfer of either the stock or of the management function to another accredited body, since (unlike in other regulated sectors) the option is not open to tenants to move elsewhere if their provider’s accredited status is removed.
32. Views are therefore also sought on the feasibility and impact of an involuntary separation of the management and ownership functions on a housing provider, and in particular on the effect of a provider’s financial viability, or its ability to borrow.

c) Self regulation

33. A more substantial departure from current arrangements would be to move to a system which was more explicitly identifiable as self-regulation. There are some elements of this within the current framework.

34. The foundation of a fuller self-regulation regime would be a code of practice covering the key activities related to social housing, which we think are broadly development, ownership and management. These would have statutory backing. In other respects, it would be for regulated bodies to ensure that they have effective measures in place to ensure compliance with that code of practice, as a condition of participation in the range of social housing activities in which they participate. These measures might include development and commitment to certification schemes for the quality of housing services.
35. Any regulatory system, including an effective self-regulation system will generate costs for regulated bodies. The option of self-regulation may offer greater transparency and choice for regulated bodies in how these costs are applied. The potential benefits are that regulated bodies can find ways of reaching required standards by budgeting for compliance in more flexible ways which reflect tenants views. These can then be applied directly to improving services rather than to the administrative costs of compliance with external regulatory requirements.

Other Key Issues

a) Residents' Voice

36. The Local Government White Paper sees users of public services being much more involved in assessing the performance of service providers in future. The White Paper also calls for the increased accountability of public service providers to their users. There are also developments in other regulated sectors to promote the 'voice' of the consumer. For example it is proposed that the National Consumer Council, Postwatch and Energywatch are merged to create Consumer Voice which will advocate the role of the consumer in the postal and energy sectors and more generally. Some sectors (water, financial services and telecommunications) have created consumer panels to check on the performance of, and deal with complaints about, providers. Are there similar developments around promoting the consumer's voice that could be adopted in social housing and help to strengthen its regulatory framework?
37. Whichever approach to social housing regulation is adopted, it will need to ensure that residents are viewed as key participants in the system rather than passive consumers of housing services. Views are sought on the role that residents can play in the regulatory framework for social housing organisations.

b) Sanctions

38. Whatever system is implemented will require the regulator to have effective sanctions in place where their requirements are not followed. At present the Housing Corporation's sanctions tend to be used in circumstances of severe failure and there are not many intermediate measures. For example, it can make appointments to an association's board, institute a statutory inquiry into its affairs and ultimately transfer the assets of the association to another RSL.

39. Professor Richard Macrory's report on regulatory sanctions sets out a potentially wider and more effective range of sanctions for regulators. This may be relevant to achieving the objectives of this review, particularly by offering a wider range of administrative penalties than the Corporation currently has within its powers. The review therefore wishes to consider the range of sanctions that gives assurances to tenants, Government and lenders, best fits the range of alternative options for the future regulatory system, and meets the 'Penalties Principles' set out in the Macrory Report. The report can be found at: www.cabinetoffice.gov.uk/REGULATION/reviewing_regulation/penalties/index.asp

c) Institutional issues

40. The review team is starting from the proposition that designing institutional arrangements should follow on from a delineation of regulatory tasks. But it seeks evidence on this aspect as well. Options could include the existing bodies involved in regulation and inspection, or a completely new body or bodies.

Summary

41. This call for evidence sets out the range of issues which the review team is considering. The **primary questions** which we are considering are:
- I. How do we identify the option for defining a regulatory framework which best meets the objectives we set out; and**
 - II. How do we develop a detailed design for the implementation of that framework?**
42. In order to assist the review team, it would be helpful if respondents could address questions in a way which assists us in achieving that objective. **More detailed questions** which respondents may want to consider in framing their evidence are:
- I. What regulatory (or, compared with the current position) deregulatory approach(es) should be applied to achieve the primary objectives we have set out?**
 - II. What specific mechanisms should be employed within these approaches?**
 - III. What are the issues associated with requiring (or not) specific organisational forms to be adopted by social housing providers?**
 - IV. What is the scope for increasing the resources available to the sector, and what changes to the regulatory framework would have a significant impact on the cost of capital or scale of debt funding?**
 - V. To what extent is it desirable or necessary to deploy different regulatory approaches to reflect the existing profile and structure of the RSL sector, and the range of activities it is engaged in?**

VI. What sanctions are necessary to ensure that there are effective levers within the regulatory framework to protect tenants and the interest of lenders and Government in social housing assets?

VII. Which approaches best lend themselves to a more tenant-focused/driven approach to delivery of social housing services?

VIII. Which organisation or organisations are necessary to deliver the regulatory approaches proposed in respondents' evidence?

43. It is not necessary to address each of these questions – respondents can identify which issues are most relevant within the context of their own submissions.

Submitting your views

44. Responses to the call for evidence should be emailed to cavereview@communities.gsi.gov.uk. or sent to Elizabeth Knapp, at 2/E1 Eland House, Bressenden Place, London, SW1E 5DU. Our preference is to receive evidence by email where possible. **Please note that our intention is to publish responses to the call for evidence, except where respondents have specifically indicated that they do not wish us to do so.** The review team can also be contacted on 0207 944 8092 (Emma Preece) or 0207 944 3635 (Elizabeth Knapp).