POLICY BRIEFING

Changes to the 'Right to Buy' Scheme

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Summary

- The Government has made significant changes to the Right to Buy scheme with the aim of increasing take up and ensuring a 'one for one' replacement of social housing sold under the scheme.
- This briefing will be of interest to executive and cabinet portfolio members and officers in the areas of housing, regeneration and finance.

Overview

The Government has made significant changes to the Right to Buy scheme (*"Reinvigorating Right to Buy and One for One Replacement, Information for Local Authorities"*) with the aim of increasing take up and ensuring a 'one-for-one' replacement of social housing sold under the scheme. The key features of the changes are:

- Replacing the regional discount caps with a significantly increased single national cap of £75,000 – a £25,000 increase on the cap proposed in the consultation paper;
- A national commitment to replace every additional home sold (as a result of the changes to the scheme) using recycled sales receipts towards the cost of replacement social housing let on an "affordable rent" (i.e. at a rent of up to eighty per cent of market rents);
- Local authorities will be able to retain all the additional receipts (generated as a result of the changes to the scheme) for replacement housing, provided they agree to limit the use of the net receipts (after certain costs) to thirty per cent of the cost of the replacement homes;
- The Government estimate that these reforms will increase take up from the current levels of around 4,000 to 23,000 sales per annum from the estimated 300,000 households that have a Right to Buy and could afford to do so.

Briefing in Full

Background

The Right to Buy ("RtB") scheme was introduced in 1980 and gives qualifying social housing tenants the right to buy their home at a discount. As a general rule, assured tenants of housing associations do not have the RtB. This is unless they were previously tenants of a local authority with a preserved RtB. The recent changes do not alter this.

As at March 2012, more than 1.9 million homes have been sold under the scheme. However, RtB sales across 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 scheme's introduction but the general trend has been downwards. According to the Government's impact assessment on the changes, this is likely to be as a result of reductions in effective discounts available to tenants; 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, the adverse credit conditions.

To qualify, tenants must have spent at least five years as public sector tenants. Once eligible, the discount rates for houses are thirty-five per cent of the property's value plus one per cent for each year beyond the qualifying period up to a maximum of sixty per cent. The discount rate for flats rises from fifty per cent by two per cent for each year beyond the qualifying period up to a maximum of seventy per cent. These discount rates remain unchanged following the recent changes. However, the maximum discount which a tenant can receive is capped ("the discount cap"). Before the recent changes, the discount cap across England ranged from £16,000 in most parts of London to £38,000 in parts of the South East.

In October 2011, David Cameron told the Conservative Party Conference that he wanted to *"raise Right to Buy discounts to a level which will make the scheme attractive again and rejuvenate the housing stock"*. In its housing strategy (*"Laying the Foundations: A Housing Strategy for England"*) the Government formally announced its intention to increase the caps on RtB discounts to enable more tenants to buy their own home. It also set out the Government's commitment to ensure that the receipts on every additional home sold under the scheme are used to fund its replacement, on a 'one to one' basis, with a new home for 'affordable rent' (i.e. at a rent of up to eighty per cent of market rents).

A detailed consultation paper was then published last December (*"Reinvigorating the Right to Buy and one for one replacement"*) with final revisions to the scheme, alongside the Government's response to the consultation, published on 12 March (*"Reinvigorating Right to Buy and One for One Replacement: Consultation -*

Summary of Responses, and Government response to consultation"). The changes were introduced through secondary legislation (*Housing (Right to Buy) (Limit on Discount) (England) Order 2012 (SI 2012/734)*) on 2 April 2012.

The Department for Communities and Local Government ("DCLG") has also published guidance for local authorities, *"Reinvigorating the Right to Buy and one for one replacement: information for local authorities"* together with a final impact assessment on the changes (*"Reinvigorating Right to Buy and One for One Replacement, Impact Assessment"*). Subsequently, DCLG has published further details on how the scheme would work between local authorities and Whitehall on 15 May.

Key Changes to the Scheme

The key changes to the scheme are:

– Increasing the discount cap to £75,000 - a £25,000 increase on the cap proposed in the consultation paper, applied nationally thereby ending regional caps which had ranged between £16,000 to £38,000, and quadrupling the discount across London and tripling it in much of the rest of the country;

– Discount rates have not changed and tenants still need to have been a public sector tenant for five years;

– Every additional home sold (as a result of the changes to the scheme) will be replaced using recycled receipts towards the cost of replacement new homes for 'affordable rent', i.e. at a rent of up to eighty per cent of market rents;

– Local authorities will be able to retain the additional receipts generated for replacement housing provided that they limit the use of the net RtB receipts (after certain local costs) to thirty per cent of the cost of the replacement homes;

– Local authorities will be able to deduct from the RtB receipts the necessary amount to cover the debt associated with the homes sold, but will not be required to use this part of the receipt to repay loans. However, proposed changes to the Housing Revenue Account ring fence will mean that this compensation can only be used for local authority housing related investment;

– The introduction of flat rate allowances for London and the rest of England for local authorities' administrative costs as opposed to deducting the actual transactional costs under the existing arrangements;

– Local authorities will for the first-time be able to deduct a certain amount from RtB receipts for the cost of withdrawn applications (£2,850 in London and £1,300 in the rest of England);

– Local authorities' ability to re-purchase former local authority homes will be restricted to an overall maximum of six and half per cent of additional net RtB receipts in addition to the existing fifty per cent limit on individual purchases;

– The 'cost floor', which ensures that properties are not sold at less than they cost to build or improve within a given time period, is retained and extended from ten to fifteen years bringing the rules into line with those for Housing Associations; and, finally

– Removing the ability of local authorities to claim any costs incurred in improving a property in the last three years from RtB receipts. This reflects the Government's view that the cost of improvement will, in most cases, be reflected in the market value and (at a discounted rate) in the RtB receipt.

There are no plans to change the entitlement and the available discounts for housing association tenants who have the 'Right to Acquire' or to housing association tenants without a right to purchase. The changes related exclusively to the Right to Buy scheme for council-owned housing. However, the estimated 620,000 housing association tenants, who used to be local authority tenants (with a RtB) before ownership of the stock transferred to a housing association, have a 'preserved Right to Buy' and will therefore fully benefit from the changes.

Changes to the discount rates

The Government's key overarching policy objective is to increase take up, thereby helping more people to realise their aspiration of home ownership. They felt the simplest and most immediate way to achieve this was to raise the discount caps thereby avoiding time-consuming changes to primary legislation, though they also recognised that in practice, most RtB discounts are limited by caps set in secondary legislation.

The Government in their consultation paper initially proposed to raise the cap to £50,000 across England as they expected this would "substantially" increase take up. However, following the consultation the Government announced that the cap would be raised instead to £75,000 (throughout England from 2 April 2012).

Whether or not a local authority tenant will benefit from the increase in the discount cap will depend on the percentage discount they are entitled to and the value of their home. By increasing the discount rate to £75,000 this has increased the 'effective discount' rates to the levels last seen in 1998/99 before the last government made a series of reforms between 1999 and 2005. These changes reduced the effective maximum discount through the introduction of lower regional caps (which were subsequently reduced further) and by increasing the qualification period from two to five years of tenancy. As a result of those changes, the average RtB discount, as a percentage of the sale price, has fallen significantly over the last ten years; from a national average of fifty per cent in 1998/99 to just, twenty five per cent in 2010/11.

In London, the fall has been even more pronounced with the average discount falling from fifty-three per cent in 1998/99 to thirteen per cent in 2010/11.

Consequently this resulted in the cap becoming the main constraint on the size of the discount rather than as originally intended, the percentage rate. The decision to introduce a £75,000 cap reverses this situation. The average 'effective discount' has been increased across all regions, and to fifty per cent in five regions and rising in London from thirteen to thirty nine per cent, in the South East from twenty-eight to forty-five per cent, in the South West from twenty five to forty-nine per cent and, in the East of England from twenty-six to forty-six per cent.

Respondents to the consultation made the point that a return to a national discount cap would take no account of regional variations in house prices and, would therefore not result in the optimum level of receipts that can be used to support new housing. It has been reported that Ministers were attracted to selling a simple and single offer to tenants, nationwide.

The Chartered Institute for Housing believe that the impact of raising the maximum discount to £75,000, will be to encourage more sales in London and other high value areas and extend discounts in middle-high value areas where some sales might have been caught by the £50,000 cap, with sales in low value areas providing poor value for money producing receipts representing a significant loss in terms of local re-provision of housing. The Government estimates that adopting a £75,000 rather than a £50,000 cap will increase projected additional sales (as a result of the reforms) by 1,500 in the remaining years of the Spending Review period (2012/13 to 2014/15).

Delivery models

A number of possible delivery models for managing the replacement programme were outlined in the consultation paper:

- local delivery – where receipts are left with the local authority to invest in local priorities which may or may not include affordable housing;

- local model with direction – receipts are left with the local authority but with a requirement that they are used for investment in affordable rent housing only;

- local model with agreement – receipts are left with those local authorities who can show they are able to deliver one for one replacement and secure good value for money; and

- national delivery model – where receipts are allocated through a competitive national programme administered by the Homes and Communities Agency (HCA) and in London by the Mayor.

The chosen delivery model is a combined approach, described as ‘Local with Agreement’ in which local authorities who have sold RtB properties have the opportunity to reinvest in replacement affordable rent properties subject to a maximum contribution from RtB receipts. They can provide the new homes themselves, or through a contract with another social housing provider. Any local authorities that are unable or do not wish to use receipts for replacement homes will submit their surplus receipts to a national pool to which local authorities and Registered Providers can bid.

There were tensions in the consultation responses between those with a desire for a “localist” approach and those who, like the National Housing Federation, argued that only a national pool has the capacity to deliver the one-for-one replacement pledge. Not surprisingly, the overwhelming majority of respondents favoured the local model or the local model with direction (sixty four per cent favoured the local model, exclusively). However, these responses did not convince the Government that the purely local models could provide for one-for-one replacement for England as a whole and the National model did not support its localism agenda.

Housing Association and Preserved Right to Buy

Arrangements for distributing capital receipts raised from preserved RtB sales depend on local arrangements made with transferring local authorities. The vast majority of tenants with preserved rights are with associations who share net receipts with local authorities.

The Government has said that they do not intend to mandate what Housing Associations do with any receipts from ‘Preserved Right to Buy’ sales as they are independent organisations. 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; though, the Government still intends to incentivise them to reinvest receipts in new social housing by:

- The Homes and Communities Agency offering to broker an investment partnership for those Associations who are not developing the main Affordable Homes Programme;
- Giving priority access to RtB receipts returned to the centre to those Associations that recycle their own receipts into new affordable housing; and
- Potential freedoms and flexibilities for Housing Associations where this would help ensure RtB funds being recycled into new affordable housing.

Distribution and the use of Right to Buy receipts

Prior to these changes once the local authority’s costs have been covered, seventy five per cent of the net RtB receipts were paid to HM Treasury and twenty five per cent were retained by the local authority which could be used for any capital purpose. Under the reforms, local authorities will be able to retain all the additional RtB receipts (generated by the changes to the scheme) for replacement housing provided they can sign up to an agreement that they will limit the use of the net RtB receipts to thirty per cent of the cost of the replacement homes. Thereby creating the incentive to outperform the one-for-one replacement pledge and, as with the Affordable Homes Programme, to lever in other investment and resources and deliver value for money. This could include borrowing supported by the additional rental income. For local authorities this will be possible only if they have sufficient headroom to borrow under the recent housing self-financing settlement.

This will work by:

– The local authority deducting certain costs such as an amount to cover the housing debt supportable from the income on the additional sales; transition and administration costs on all sales;

– Then deducting an amount which reflects the income the local authority might reasonably have expected from RtB sales prior to the new scheme (reflecting the already agreed housing revenue account self-financing settlement);

– The local authorities must also pay the Government an amount which reflects the income which the Treasury expected from RtB sales prior to the new scheme (to leave the 2010 Comprehensive Spending Review settlement intact);

– Once these costs are deducted, the remaining receipts (the ‘net receipts’) are available to fund and, must be applied to replacement affordable rented homes.

Where local authorities do not wish to enter in such an Agreement, the remaining receipt will be returned to the DCLG and then re-distributed for new affordable rented housing by the HCA (or, in London, the Greater London Authority). Similarly, if additional RtB receipts remain unspent after three years they will be returned as will any overspend over the thirty per cent limit, to central government to be reinvested in housing building nationally.

One to one replacement pledge

Historically, the RtB 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. Indeed there were some years like in 1987 when Right to Buy sales exceeded total house completions (by local authorities and housing associations) by more than four to one. Therefore the recognition of the need to replace social housing stock that is sold under the RtB has been welcomed or at least has muted any opposition to the reforms in the mainstream press. Nonetheless a great deal of scrutiny has taken place from those within the local government and housing sectors on the Government’s pledge. There have been very real questions around one-to-one replacement as opposed to like-to-like replacement, for instance:

– The replacement housing will be let at an affordable rent of up to eighty per cent of market rents (consistent with the Affordable Homes Programme) which will make social housing more expensive in many areas;

– There is also the real risk that an increase in take up of the RtB will lead, as it has in the past, to ‘cherry picking’ with local authorities left with inferior stock and locations which cannot be addressed even through a one-for-one replacement; and

– There is the very real possibility that under one-to-one replacement, a family home could be replaced with a one bedroom flat.

Indeed, the Government has made clear that local authorities *“will have the freedom to decide on the type, size and location of the new homes they build according to local needs.”*

Respondents to the consultation also expressed considerable concern around whether the proposal to lift the cap to £50,000 would generate enough receipts to deliver one-to-one replacement of properties sold; which is arguably made much harder by the Government’s decision following the consultation to increase the cap further to £75,000. There were particular concerns raised on the impact on rural areas relating to a combination of adequacy of the receipts and the lack of available land in rural communities.

The Local Government Association’s (LGA) response to the consultation noted that the replacement programme “will require input of significant additional resources” and have questioned whether the borrowing caps imposed under the new local authority housing self-financing system will restrict local authorities’ ability to find the additional funding required. DCLG is reportedly of the view that local authorities must work within their existing borrowing limits and should work with partners and make the best use of their land, assets and other resources, instead of putting in capital or increasing borrowing in order to facilitate replacement.

Responding to its critics the Government has pointed out that the aim is to deliver one-for-one replacement <u>nationally</u>, that it recognises that receipts will not be large enough to fund one-for-one replacement in some areas and, there is no requirement on local authorities to replace the stock on a ‘one-for-one’ basis. The Government has estimated that for example, receipts in the North West may be insufficient. While in London the receipts from a single sale could support more than one affordable rent replacement home.

In response to the specific concerns about rural areas the Government has pointed out that it is retaining the restrictions on the resale of RtB homes in rural areas. Calls to add National Parks to the list of RtB exemptions have been ignored with the Government maintaining that the decision to allow receipts to be used for up to thirty per cent of replacement costs reflects any increased costs in the development of new affordable homes in rural areas. The Government's position might also reflect their belief that even with the bigger discounts, higher property values coupled with lower incomes mean that take up will continue to be low in rural communities.

Based on its experience from the Affordable Homes Programme the Government has estimated that the average construction cost of a replacement home unit nationally will be between £133,000 and £150,000. The average amount of provider provision under the Programme is around £34,000 for local authorities and £45,000 for Housing Associations. To make this work the Government has estimated that the contribution needed from the sale receipt to fund a replacement will be between £40,000 and £45,000. This is within the £55,000 estimated average net receipt (£72,500 gross) based on a £75,000 discount cap. The £50,000 cap would generate an additional £7,500.

The Government illustrative funding sources for replacement, per home

	Local Authority	**Housing Association**
Right to Buy net receipt	£40,000	£45,500
Borrowing Requirement (against future rental income)	£59,000	£78,000
Provider Provision (this can include land)	£40,000	£45,500
Total Replacement Cost	£133,000 to £143,000	£140,000 to £150,000

Comments

The Right to Buy scheme has been one of the iconic public policies of the last thirty years. Whilst council house sales took place before, it is a policy synonymous with Margaret Thatcher's legacy. It was to prove the biggest single privatisation of the Thatcher era raising £28 billion, more than the sale of gas, electricity and British Telecom put together. It also, according to Nicholas Timmins, provided the Conservatives with votes in places where they never had votes before, helping them to retain their position in Government for the next decade or so.

At the time of its introduction Michael Heseltine described the Right to Buy as *"an irreversible shift of wealth in favour of working people and away from the state".* If it was introduced today, David Cameron would probably describe it as part of his 'Big Society'. Despite their criticism of the Labour Government's reforms to the scheme which the Conservatives saw, not entirely correctly, as leading sales to drop to barely a few thousand a year, there was no commitment in either their 2010 Election Manifesto or the Coalition Agreement to reverse those changes. Even the 2009 Conservative Party Housing Green Paper had only proposed to extend tenant's preserved rights.

What subsequently changed was an increasing emphasis on housing policy in the Coalition Government's second year and the political need to have a housing strategy. In the short term this sought to highlight the missed opportunities under the Labour Government. In the longer term it seeks to build political stock with those beneath the housing ladder ahead of the 2015 General Election. The reinvigoration of the Right to Buy plays well with that and with Conservative backbench MPs and the 'Tory Heartlands' with notions of their past political glories.

Winning over HM Treasury

There was also an opportunity for a "win win" to realise the value of the existing housing stock to build new homes addressing head on the fundamental criticism of the scheme that it shrunk the social housing stock; nudge the Coalition Government closer to its pledge to build up to 170,000 new affordable homes by 2015; and, at the same time to work (alongside ''First Buy' and 'New Buy') to stimulate the housing construction sector - all with no additional Central Government expenditure.

An attractive proposition for the Treasury who still had be persuaded to waive their 'rights' to this income stream, as before the changes seventy five per cent of net RtB receipts were accrued to Whitehall. When the Conservatives first formally encouraged council house sales in 1970 it was promoted as a way of raising capital for new council housing, but in the 1980s when faced with the budget deficit the Thatcher Government compelled local authorities to use RtB receipts to pay off their debt. As we face similar, if not worst, circumstances, the Treasury has been persuaded to wave its 'rights' over this income stream by protecting their expected income from the scheme chalked up in the last Comprehensive Spending Review. Only the additional receipts will be ring-fenced for replacement homes.

However, Treasury officials probably saw that the revised scheme put another 'nail in the coffin' in Government grants supporting social housing and moved the spotlight to an area where they have been keen to focus for a number of years – the value residing in the existing social housing stock. For years Treasury officials have been pouring over the books, particularly those for the housing association sector, seeing what they consider to be their investment (i.e. past Government Grant) not working for them. Ideally, they would probably wish to have adopted the same delivery model for replacement homes for local authorities, to housing associations.

Extending Right to Buy to Housing Associations?

Instead, the Government is deploying incentives on housing associations to recycle receipts much as expected for local authorities. To go further would have meant clashing with the sector over their independent status which, while it is ill defined (for example, they are categorised as those of a “public authority” for the purposes of the Human Rights Act and judicial review) is fiercely guarded by the National Housing Federation and its membership. They like to remind the Treasury that their independence protects the Treasury from housing associations becoming an ‘on balance’ sheet problem for them. But, it is a weak defence that does not align well with the position taken by the European Union and previous positions taken by the Treasury (e.g. Network Rail) on such matters and the rapidly decreasing Government grants supporting the sector. Besides, there is already a vastly inferior statutory ‘Right to Acquire’ scheme for housing association tenants.

Fully extending the Right to Buy to housing association tenants (or significantly increasing the discounts under the ‘Right to Acquire’ scheme) would, be a ‘feather in the cap’ for the policy and the Government’s aims for increasing home ownership. Indeed, early in the year the Institute for Public Policy Research published a paper from two prominent Members of Parliament, David Davis and Frank Field (“Right to buy 2.0”) providing proposals to do just that. In response to which Housing Minister Grant Shapps, who is known to be in favour of such a plan, has said the government would consider the idea as part of its review of housing policy.

For now, the Treasury will be comforted that 630,000 housing association tenants have preserved RtB rights and eighty five per cent of those come under agreements with local authorities which share the net receipts strengthening the incentives to replace the homes sold (rather than reinforce cash reserves). Nonetheless, the Treasury will be keeping watch on this issue in the run up to the next Comprehensive Spending Review. Though, with a million housing association tenants without a Right to Buy and, with Government searching for cheap growth stimulates, maybe changes will come sooner rather than later?

Will the changes deliver?

The key consideration in making changes to the scheme was maximising take up whilst ensuring value for money and that the average sale receipt will be sufficient for the replacement on a ‘one for one’ basis based on an affordable rent model.

It will be interesting to see who will get the blame if a one-for-one replacement is not obviously delivered. The Government has made clear that it is a national pledge. But rather than go for the national delivery model, which would have given greater certainty and control whether this is delivered or not, they have placed their fate in the hands of local authorities.

What the Government is hoping for is that areas in London and in the South East of England will be able to ‘out-perform’ the policy and deliver more than a one-for-one replacement and make up for the shortfall elsewhere. Consequently, what we could see is a gradual shift in the number of council and social housing from the North and the Midlands to London and the South East, perhaps even from Stoke to the London Borough of Newham? While that might just reflect demand, it is also an emotive political issue, though one which might take a number of years to be noticed.

Nonetheless, this may be insufficient unless a significant number of local authorities in low value areas are willing to give up their surplus receipts to the national pool. This seems unlikely, as even new investment short of one-to-one replacement would be welcomed locally against the alternative.

In practice, even in the London and the South East there are a number of potential hurdles. Notably in terms of demand, access to mortgage finance could be a significant brake on take up. The Government predicts an initial increase in sales, not only as a result of the increased discount, but also, as a result of house prices and interest rates remaining initially low. However, rising interest rates and house prices will eventually produce a downward pressure on levels of sales. But we also know that access to funds to meet increasing deposit requirements and Stamp Duty is often the bigger hurdle for first time buyers than the affordability. While these factors are currently suppressing the housing market more generally, they may be even more pronounced amongst prospective RtB purchasers (i.e. as result increasing threat of unemployment, higher impact of inflation on real and those on lower incomes).

Indeed, whilst welcoming the changes the Building Societies Association has highlighted the “risky” nature of RtB mortgages with forty per cent of RtB mortgages having payment problems with nine per cent in arrears. These figures rise significantly when combined with other factors, for example, eighty-seven per cent of RtB mortgages to credit impaired and self-employed borrowers have experienced payment difficulties. Mortgage providers are therefore likely to approach RtB mortgages with caution. This is understood by Government, as while effective discount rates are to return to the levels last seen in 1999, projected sales after these new changes are significantly lower than they were in that same year. That will leave many tenants disappointed and local authorities glad that they are to be compensated for withdrawn applications. Will local authorities and, housing associations in London and the South East see it in their interests to fill that gap (as some are doing to help first time buyers, more generally) in the name of increasing housing supply? We will have to wait, and see.

For more information about this, or any other LGiU member briefing, please contact Janet Sillett, Briefings Manager, on janet.sillett@lgiu.org.uk