



# Does size matter

– or does culture drive  
value for money?

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## 1 Introduction

In 2005 CIH produced its briefing *Is big really best – or can small and friendly deliver?* The publication considered the impact of size in relation to the efficiency and performance of housing associations in England, and whether particular types of housing association were better performers. Debate at the time was in part driven by the regulator investing in a smaller number of developing housing associations and the Housing Corporation's expectations about the outcomes from mergers in terms of organisational capacity and services to tenants.

Today, fundamental changes to the economic climate, regulation and investment funding models are likely to have a profound impact on the operating environment for housing associations. With the newly increased emphasis on governance, viability, and value for money (VFM) it is timely to revisit our earlier research and reconsider what makes for the 'best' performing organisation. This report considers how equipped the sector is to respond to the new policy drivers and make best use of its capacity both now and for the future. At the time of publishing this research, the current regulator the Tenant Services Authority (TSA) is consulting the sector on its revised VFM Standard.

We have revisited the approach taken in *Is big really best – or can small and friendly deliver* to consider how issues such as size, structure and geography impact on the efficiency and performance of housing associations today; and how these factors affect the sector's ability to respond proactively to its changing operational environment, while at the same time delivering efficient services to customers?

### Challenges faced by the sector

Major changes now taking place which are likely to have a significant impact on the housing sector include:

- Development of new homes increasingly linked to local markets and the 'sweating' of assets
- Introduction of more market-oriented rents and flexible tenancies
- Welfare reform (including the ending of direct housing benefit payments) – likely to expose tenants to increased financial risks, especially given the current economic climate
- Increased importance of VFM in government's attitude towards housing associations
- Funders may increasingly differentiate between housing associations in terms of cost of funds and loan covenants
- Longer-term debt has migrated towards the capital markets, and banks have tended to gravitate towards shorter-term facilities
- A future regulatory system designed to deal with cases of serious failure only, and the impact of scaled-back regulation on lenders' assessment of risk
- An onus on landlords to develop their own approaches to the way they manage their business, services, and assets, as opposed to being driven by compliance with regulatory requirements
- Demographic change, particularly catering for an ageing population
- Low carbon housing and environmental sustainability becoming more central to housing associations' business considerations.

These changes will mean:

- More uncertainty and fluidity in relation to processes, markets, and funding
- Housing associations having to manage their assets in a different, more entrepreneurial/commercial manner
- Stronger emphasis on housing associations generating their own capital
- Housing associations' needing to focus more proactively on efficiency, effectiveness and VFM
- Greater emphasis on financial returns as housing associations are forced to use their capital, assets and revenue more effectively.

These fundamental changes raise serious questions about how housing associations remain fit for purpose and deliver their objectives in this changing environment, to be addressed in this report:

- What size, type of structure and geography will enable housing associations to react proactively to the changing environment?
- How can they improve their VFM and demonstrate their improvement?

**This report is not intended to give a definitive analysis of the issues around size and structure in the sector; nor does it represent the views of any of the organisations in the study. Rather, it is a discussion document intended to encourage and take forward a debate within the sector about these issues.**

## 2 What did the research tell us?

Research findings are presented in this report across the following areas:

- **Costs, performance and economies of scale**
- **Scale, diversity and local delivery**
- **Future options – diversification and developing into new markets**

The key findings include:

- **Cost, performance and size are not directly linked**  
There is little evidence that size, better quality services and lower costs are related, with significant variations in cost between housing associations existing within the sector. Indeed, there is evidence of a correlation between high cost and poor performance, which can be interpreted in different ways.
- **Scale alone does not automatically provide efficiency**  
Analysis of both HouseMark and TSA data did not provide any statistical evidence of economies of scale to be achieved through size.
- **Mergers offer no guarantees of improvement**  
The research found no automatic benefits for effectiveness and efficiency from mergers. However, the two larger case study housing associations Affinity Sutton and Bromford Housing Group, clearly demonstrate that growth brings with it significant opportunities for scale-related efficiencies, though these are not generated by increased size alone. Organisational transformation is necessary in order to benefit from, and maximise, efficiencies as the opportunities arise.
- **The importance of emphasising value in VFM**  
Evidence from all three case studies suggests that housing associations need to make clear decisions about how they get the best VFM whilst pursuing their organisational values and priorities. It is important that the focus is not principally about cost savings and financial improvement, or driven purely by a regulatory standard. VFM should be integrated into an housing association's culture as a matter of course.
- **Costs: four significant factors**  
The TSA's regression analysis of overall housing costs shows that four measured factors explain over 50% of the cost variations – deprivation, regional wages, decent homes and supported housing.  
Deprivation and region of operation also feature as factors in HouseMark analysis. With the likely impact of economic pressures being increased deprivation amongst tenants this will present on-going challenges to housing associations in terms of costs and performance.

### 3 Methodology

Given increasing competition to secure development funding and greater emphasis by the regulator on efficiency and VFM, this research has focused heavily on evidence about overall costs and effectiveness of service delivery. This report considers the key findings of the TSA's regression analysis of overall housing costs, and HouseMark's regression analysis of cost/performance for both housing management and repairs models.

Three key sources of evidence are:

- HouseMark's cost and performance data. For the purpose of this research, we adopted the aggregate performance scores by activity area and expanded them to create a combined housing management performance score and a combined repairs performance score. These were each paired with the cost indicators which HouseMark collects for housing management and repairs in order to categorise which housing associations were 'best' according to both cost and performance. The analysis was based on around 297 HouseMark core benchmarking returns for 2009/10, of which around 250 provided a complete data set for modelling purposes.
- The TSA's 2010 research *Understanding unit costs of housing associations: regression analysis* published in 2011, which sought to test the effects of a long list of explanatory factors (over 70 variables) on housing association costs, using around 320 complete data sets, over a 6 year period to 2010. We used this in conjunction with further work by the TSA to update their analysis to consider the cost drivers.
- Detailed interviews and visits to three very different housing associations, which each place a strong emphasis on efficiency and VFM:
  - *Affinity Sutton*, a national association with over 57,000 units, located mainly in the South and East of England.
  - *Bromford Housing Group*, based primarily in the Midlands and South West with over 27,000 homes.
  - *Soha Housing*, a stock transfer association with over 5,500 homes based in Oxfordshire.

In terms of evaluating VFM, both the TSA and HouseMark approaches are important, but they tell us something different. The TSA data covers housing associations with more than 1,000 units. HouseMark data has no specific cut-off in terms of numbers of units, but there are only a few housing associations with less than 1,000 units.

#### **Note: Analysis**

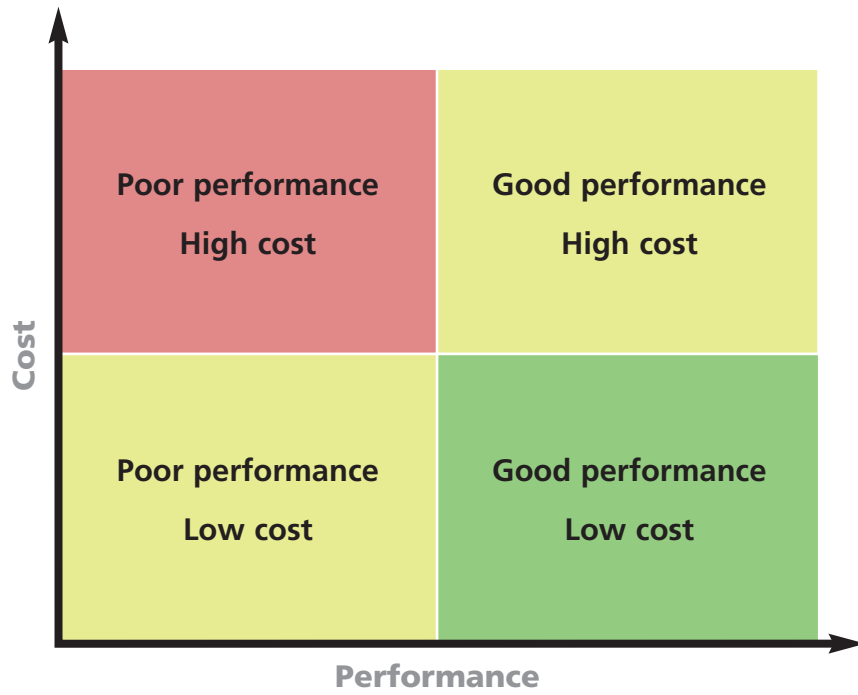
Regression modelling is a statistical technique which allows the effects of a particular factor to be isolated while all other factors in a model are held constant. In regression analysis the relationship between a dependant variable and one or more independent variables is tested.

#### **How was 'best' defined?**

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For the purpose of this research, 'best' is defined using a combination of cost measures and performance indicators which are collected and validated by HouseMark, in the form of a quadrant plot of performance versus cost. Housing associations lying in the 'above median performance, below median cost' quadrant (coloured green in the diagram on the next page) have been labelled 'best' for the purposes of the report.

Figure 1: HouseMark quadrant plot of performance versus cost



## 4 Costs, performance and economies of scale

This first section sets out findings from the TSA and HouseMark regression analysis, in relation to costs, performance and economies of scale, and compares results with the experiences of the three case study housing associations. Later in the report we also consider the impact of scale and diversity on local delivery. Appendices one and two set out in detail the relevant results from the TSA and HouseMark work.

### Cost trends

The TSA report says that:

*'Trends in measured explanatory factors cannot account for the pace of cost inflation in the housing association sector between 2005 and 2010.'*

And that:

*'One theory is that costs across the sector are largely determined by available revenues.'*

This argument, often expressed over recent years, for example in the Cave review,<sup>1</sup> is that there are few efficiency pressures on housing associations to push down their costs. That is, individual housing associations chose how efficient to be. This is facilitated in part by rents being allowed to rise at more than the Retail Price Index (RPI) against borrowing costs, which are low in historical terms.

#### Global accounts 2010: decreasing operating costs

Evidence that housing associations are now looking harder at their costs can be seen from the global accounts 2010<sup>2</sup> which found that 'for the first time in many years, operating costs per unit decreased in real terms, particularly in management and major repairs' and that operating margins increased during the financial year from 14% to 18%. TSA analysis<sup>3</sup> shows prior to reducing in 2009/10 operating costs have historically risen year on year since 2005. Average annual growth rate in nominal operating costs per unit, at 3.6% between 2005 and 2010 was considerably above inflation.

Global accounts can be found at: [www.tenantservicesauthority.org/server/show/ConWebDoc.21183](http://www.tenantservicesauthority.org/server/show/ConWebDoc.21183)

But the data is not up-to-date and the three housing associations who took part in this study demonstrate that good landlords are already proactively focusing on efficiency. They cite a range of pressures on housing associations which force them to look hard at their costs, in particular:

- The new funding regime for development, with its emphasis on sweating assets and increasing debt levels
- The general economic climate and rising inflation
- Planning for the changes in welfare benefits and the end of HB direct payments, which combined with the general pressure on incomes (see box on page 9) are likely to make managing tenancies, collecting rents and forecasting rental income more challenging in the future
- For those housing associations providing care and support, the increased level of competition and squeeze on commissioners budgets.

<sup>1</sup> Report of the independent review of social housing regulation, (2007) DCLG

<sup>2</sup> The global accounts of housing providers (2010) TSA

<sup>3</sup> Technical paper; Understanding unit costs of housing associations – regression analysis (2011) TSA



### The economic pressures on social housing tenants

After a sharp fall resulting from the economic downturn, wages are predicted to recover only very slowly. Based on current government forecasts, we expect that average wages will be no higher in 2015 than they were in 2001.<sup>4</sup>

We found that on average, poorer and households dependant on welfare benefits experienced higher inflation rates over the last decade than richer and non-benefit-dependent households.<sup>5</sup>

As governments attempt to reduce the deficit, household incomes now look set to be squeezed for a considerable length of time. In the most recent financial year (2010-11), UK earnings, state benefits and tax credits all fell in real terms. Institute of Fiscal Studies (IFS) researchers estimate that this is likely to have led to a fall in median net household income of 3.5%, the largest single-year drop since 1981, returning it to its 2003-04 level.<sup>6</sup>

### Costs: significant factors

Regression modelling is a statistical technique which allows the effects of a particular factor to be isolated while all other factors in a model are held constant. In regression analysis the relationship between a dependant variable and one or more independent variables is tested. This report considers the key findings of the TSA regression analysis of overall housing costs, and HouseMark regression analysis of cost/performance for both housing management and repairs models.

The TSA regression analysis of overall housing costs shows that *measured explanatory factors* explain a large part of cost variation, with four factors explaining over 50% of the variation:

- Deprivation levels in areas of operation
- Regional wage levels
- Costs associated with achieving decent homes
- Levels of supported housing stock.

In contrast, the HouseMark regression analysis of cost/performance for housing management shows the following factors explain a large part of cost variation:

- Organisational type
- For large scale voluntary transfer (LSVT) associations, the age of the organisation since the original transfer
- Deprivation levels.

HouseMark's regression analysis of cost/performance for repairs shows the following factors explaining a large part of cost variation:

- Region of operation
- Levels of deprivation in areas of operation
- Whether or not the housing association has a direct labour organisation (DLO)
- Percentage of overheads as a proportion of operating costs.

4 *Growth without gain* (2011) Resolution Foundation

5 *Spending patterns and the inflation experience of low income households over the past decade* (2011) IFS

6 *The Effect of the Great Recession on the Household Income Distribution* (2011) IFS

### Costs: four significant factors

While a number of different explanatory factors emerge from the TSA and HouseMark work, **deprivation** appears as a significant factor in all three analysis models.

- The TSA's regression analysis of overall housing costs shows that four measured factors explain over 50% of the cost variations – deprivation, regional wages, decent homes and supported housing.
- Region of operation also featured in both the HouseMark regression analysis, meaning that achieving high performance on costs and services is more challenging for housing associations operating in higher cost regions and deprived areas.

With the likely impact of economic pressures being increased deprivation in some areas this will present on-going challenges to housing associations in terms of costs and performance for the future.

## Cost and performance

There is, however, little evidence that size, better quality services and lower costs are linked, with significant variations in cost between housing associations occurring:

- TSA analysis shows that only part of the variation can be explained by factors such as regional wage differences, the amount they have to spend on repairing their stock and the level of deprivation in the areas in which housing associations work
- HouseMark data indicates a moderate negative correlation between housing management costs and performance (as costs increase, performance has a tendency to decrease).

The issue of 'high costs-poor performance' can be interpreted in many different ways, ranging from arguing for increased investment in poor performing areas to remedy the problem, through to a general lack of focus on efficiency' as just a couple of examples.

It is important that individual housing associations and the sector understand why higher costs do not necessarily deliver high performance. Understanding costs is essential to improvement, and goes hand-in-hand with an appreciation that driving down costs through efficiencies does not necessarily mean cutting services.

### Cost, performance and size are not directly linked

There is little evidence that size, better quality services and lower costs are related, with significant variations in cost between housing associations existing within the sector. Indeed, there is evidence of a correlation between high cost and poor performance, which can be interpreted in different ways.

## Deprivation

Deprivation emerged as a significant factor in all three separate analysis models.

The TSA found that moving from a housing association with stock in neighbourhoods with median levels of deprivation to one operating in very deprived areas is associated with increased social housing lettings costs of around a third, or £1,000/unit per annum on average.

Their report says that:

*'Almost certainly deprivation is picking up a range of factors associated with increased costs: more intensive housing management and anti-social behaviour activities, increased letting costs through faster stock turnover, regeneration initiatives and in all probability older stock.'*

HouseMark research also supports deprivation being a significant factor in terms of performance. For both housing management and repairs it found that the greater the level of deprivation, the less likely a housing association was to be 'best' on its combined cost/performance measure.

Given the economic pressures outlined previously, there is likely to be increased deprivation in some areas, presenting an on-going challenge to housing associations in terms of both costs and performance.

## Region of operation

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Differences in performance and costs between regions were also significant in both the HouseMark and TSA regression analysis models.

The TSA work suggests the difference in costs is directly related to wages. It found that the whole of the differential in regional wages is translated into higher costs. This means that, on average, costs for housing associations operating solely in London are 40% higher than for otherwise similar housing associations operating in the North East.

The HouseMark repairs model showed significant regional differences on which housing associations were likely to be 'best'. Regionally, housing associations operating predominantly in London are least likely to be 'best' for repairs, followed in increasing likelihood by those in the South West and then the South East. This variation occurs despite HouseMark's area cost adjustment (ACA) being applied to costs in graduated bands from inner London to outer London to the rest of the South East. At one extreme, for housing associations in London without a DLO and at the median level of deprivation, the probability of being 'best' as predicted by the model is 4 per cent. At the other extreme, for a housing association in the North East without a DLO and at the median weighted index of deprivation, the probability of being 'best' as predicted by the model is 53 per cent.

Region of operation was not as significant in HouseMark's housing management model, as it was overshadowed by other factors such as organisational type, deprivation and – for LSVTs – age.

An interesting finding from the HouseMark work is that for repairs costs per property, there is no significant difference between London and the other regions, once HouseMark's area cost adjustment has been applied.

The HouseMark work did not specifically focus on regional wages, but did find that there were regional differences, in particular in London where housing association management costs per property are higher than elsewhere in England, even after the London and South East cost adjustment has been applied. Given that housing management is particularly labour-intensive, this could be explained by higher wages in London.

## Overheads

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HouseMark's analysis showed the overheads variable was particularly important in explaining whether or not a housing association was 'best' for repairs. As the percentage of adjusted operating costs which are overheads increases, the probability of being in the 'best' quadrant increases.

For example, for a housing association without a DLO in the East region and with the median level of deprivation, the probability of being 'best' as predicted by the model is 33% for median overheads (16.7% overheads); this probability increases to 57% for upper quartile overheads (20.4% overheads).

Some commentators may suggest that high overheads as a percentage of overall operating costs could reflect the significant investment in strategic leadership, policy and market analysis, and business development roles/skills necessary to steer the housing association and develop the

strategic vision needed to achieve 'best' in today's market. This may be coupled with investment in staff development and training across the board to ensure the housing association is able to implement that vision effectively, and deliver against its strategic goals.

While this suggestion supports arguments made later in this report that strong leadership, enhanced business skills and market knowledge drive 'best' in terms of cost/performance, further investigation would be helpful to understand if this is the case, or why the greater the proportion of overheads as a percentage of overall operating costs, the more likely a housing association is to be 'best'.

## Direct labour organisations (DLOs)

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There are already established markets in repairs, cleaning services, grounds maintenance and estate management. Although there is a current trend among housing associations to bring back repairs and maintenance services in-house following the recent financial demise of a number of large scale private contractors. There are also examples of outsourcing other functions such as financial services and automated rent payments. However, there have been few attempts by housing associations at outsourcing customer services either as a whole (or in part).

Examples of housing associations entering into management agreements with other housing associations are still limited. This is partly due to the ownership of assets being the key to raising funds for development. Some capacity can therefore become 'trapped' if the smaller organisation focuses on housing management alone.

Though the TSA data did not find any clear evidence of whole organisation cost savings where contracting out of general needs management has occurred, HouseMark analysis found housing associations with an outsourced repairs function are more likely to be 'best' for repairs than those with an in-house DLO.

## Supported housing and decent homes

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The HouseMark work reinforced the significance of decent homes investment as a key factor in determining costs, but did not find evidence that backed-up the TSA's findings in relation to supported housing.

The TSA found that each unit of supported housing is associated with additional operating costs of £8,200 per annum on average compared with a general needs unit. HouseMark, however, found that the ratio of supported housing in the stock was not a significant influence on repairs or housing management cost/performance.

## Delivery of housing management and repairs services

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Some interesting issues emerge from the HouseMark research in terms of the costs and delivery of housing management and repairs services.

The research found a moderate negative correlation between housing management cost per property and housing management performance score. This means that, as housing management costs increase, housing management performance tends to decrease.

For traditional housing associations, there is also a moderate negative correlation between repairs cost per property and repairs performance score. As repairs costs increase, repairs performance tends to decrease.

## Transfer associations

TSA found that stock transfer associations have higher costs than otherwise similar traditional associations in their early years. This may be a fairly obvious conclusion given the purpose of most transfer associations in relation to dealing with repairs backlogs.

The 2010 global accounts also show that the operating margins for stock transfer associations are increasing as they are:

*'Benefiting from decreasing repair costs as providers meet the requirements of the DHS and the decreasing number of new transfers.'*

What is more interesting is the finding of HouseMark's regression analysis of cost/performance in relation to housing management performance. Out of the housing association types:

- LSVTs which transferred over 12 years ago
- Those which transferred 7-12 years ago
- Those which transferred less than 7 years ago, and
- Traditional housing associations

It is the LSVTs which transferred earliest that are most likely to be in the 'best' quadrant for housing management. These are closely followed in likelihood by LSVTs who transferred less than 7 years ago. The 'middle-aged' LSVTs are significantly less likely than other LSVTs to be 'best' for housing management.

By far the least likely type of housing association to be 'best' are traditional ones. Overall, for housing associations with median levels of deprivation, the probability of being 'best' as predicted by the model is 9% for traditional associations, 46% for 'middle-aged' LSVTs, 57% for 'young' LSVTs and 61% for 'older' LSVTs.

There are a number of possible reasons for this:

- Higher costs at the outset laid the foundation for good performance
- A strong focus of LSVTs on providing improved homes leads to stronger interaction with their tenants
- The transfer process itself involves interaction with tenants which supports good service delivery
- Most transfer associations have a strong focus on management and repairs without the added complexities of development.

### Unexplained cost variations

Even though the factors listed above explain over 50% of costs, this still leaves considerable variation in costs between housing associations. The TSA research rightly said that the variability of unexplained costs between smaller and larger housing associations is not surprising:

*'...however, it is perhaps surprising that there is still significant variability for medium-sized landlords with around 10,000 units. The distance (negative or positive) between actual and predicted costs for these landlords is around £800, only slightly lower than the level for the smallest landlords in the sample (£1,200).'*

Given the diversity of housing associations in terms of the geography and markets in which they work there is likely to be a degree of cost variation. However, it is important that housing associations properly benchmark their costs and ask why their costs are different from others.

A full and rounded assessment of VFM will draw on a range of data sources extending beyond cost benchmarks. Whatever their basis, data on cost and performance are only part of the story. Benchmarking these should be seen a useful tool for helping understand performance and inform a housing association's strategies.

## Efficiency – for what?

The conventional response to increasing financial pressures is often to ‘batten down the hatches’ to reduce spending, or achieve greater efficiency by squeezing costs through wage freezes, reducing pension entitlements and so on. These measures may well have their place, but they need to be part of a wider focus on trying to improve the way outcomes are delivered.

We have considered previously some of the significant factors affecting cost and performance, and where efficiencies might be achieved. However, it is vital that the sector is not principally focused on cost savings and financial improvement. Efficiency aims should be about meeting the overall objectives of the organisation (including its wider social investment values and aims) and how cost savings can be used to meet those objectives in the most effective way.

This was reiterated by all three housing associations involved in the research, who stressed the prime importance of having an effective strategic process for setting organisational priorities, owned and led by the board. This includes clarity about the role of cost savings and efficiencies in the delivery of objectives, and of organisational arrangements for delivery.

### Clarity about cost savings and strategies

Analysis has shown there is no particular type or size of housing association that is most effective in terms of costs or performance, and that clarity about purpose, values and outcomes is an important factor in housing associations’ success.

### Case study: Affinity Sutton – transformational change

Affinity Sutton is one of the largest housing associations in the country with 56,000 properties in more than 120 local authority areas. During 2009 the group embarked on a major internal programme known as ‘Transition’, aimed at transforming the organisation.

The group was brought about by a merger between two large organisations of similar size, rather than the more usual merger involving the absorption of a smaller organisation into a much larger group. A decision was taken to rationalise structures with a view to developing a more efficient approach and delivering consistency in services, based on work to scope out what future services might be needed to face the challenges ahead.

The overall objectives were to:

- Create one organisation
- Develop and plan a vision for the future
- Establish consistent systems across the group
- Review how the board structure worked.

The programme included changing governance and operational structures, reshaping services to customers, and reviewing IT and office accommodation. Communication and consultation with staff, residents and stakeholders was a key aspect and was undertaken in three distinct phases – pre-approval, transition and implementation.

The primary objective of the consultation activities was to connect people personally with the aims and ambitions of Affinity Sutton through timely and relevant communication. A new approach, building on and adding to existing communication channels, was developed to target each group. Success of the consultation was measured in part through a brand tracker survey which found that Affinity Sutton had 24% ‘front of mind awareness’ among residents in the spring of 2010, which subsequently rose to 38% a year later.



**Outcomes of the Transition Programme include:**

Business area	Outcomes
Efficiencies	<ul style="list-style-type: none"> <li>• Reduced three separate service delivery structures into a single structure with local delivery mechanisms</li> <li>• Large-scale efficiencies by combining all centralised functions including finance, HR, company secretary, development and IT and communications, resulting in a headcount reduction of 70 posts, including four directors</li> <li>• Combination of centralised functions, headcount reductions and optimised procurement has led to savings in the region of £15m</li> </ul>
Customer services	<ul style="list-style-type: none"> <li>• Increased opportunities for tenants to contact the organisation</li> <li>• Improved focus on providing a speedy and consistent service</li> <li>• More tailored services to reflect the different needs of customers and locally determined priorities</li> </ul>
Governance structure	<ul style="list-style-type: none"> <li>• In September 2011 the creation of a single company has significantly reduced resources required to maintain and service three separate landlord boards</li> <li>• Simplified the accountability and governance structures</li> <li>• Introduction of three regional scrutiny panels where resident-led panels are responsible for scrutiny of local service performance information which enables the group to respond to local agendas as readily as it responds to national agendas</li> </ul>

**Emphasising ‘Value’ in Value for Money**

Government is currently placing a strong emphasis on value for money (VFM) for the sector, and at the time of publication of this report the TSA is consulting on its VFM standard.

Our research demonstrates the importance of linking cost and service delivery performance information to get a balanced view of VFM. However, the sector should be careful to avoid the danger of focusing more on costs than on their link with outcomes – of concentrating only on the ‘M’ in VFM and not the ‘V’.

A strong focus on VFM is not something that should be driven purely by a regulatory standard, but should be integrated into a housing association’s culture as a matter of course. With the future regulator taking a scaled-back approach to consumer protection, housing associations will have to be proactive in demonstrating to stakeholders, investors and tenants that they are efficient in their activities, and demonstrate a balanced approach to consumer and economic self-regulation. Many tenants are already disproportionately affected by the current economic situation and social landlords have an increasing responsibility to demonstrate to tenants that they are operating as efficiently and effectively as possible, offering an open and transparent approach to tenant scrutiny and self-regulation.

**The importance of emphasising ‘value’ in VFM**

Evidence from all three case studies suggests that housing associations need to make clear decisions about how they get the best VFM whilst pursuing their organisational values and priorities. It is important that the focus is not principally about cost savings and financial improvement, or driven purely by a regulatory standard. VFM should be integrated into a housing association’s culture as a matter of course.

### Case study: Bromford Housing Group – achieving operational efficiencies

Bromford Housing Group achieved a significant improvement in operating margins through its efficiency drive and operational changes. In the early days of the 'credit crunch', Bromford recognised that the economic downturn was likely to be different to those previously experienced in UK history and that they needed to take a proactive approach to the economic uncertainty. Mirroring the government's emergency committee, COBRA, an internal team was established to focus on managing the risks and consequences of the external world, particularly with regard to new development exposure to financial risk. In addition, a Better Business Team was set up to rigorously scrutinise efficiency and the value of services provided, with a focus on value for money and making radical changes to improve efficiency.

To ensure it continued to thrive, Bromford needed to challenge how it operated. Nothing was 'off scope' except for the absolute given that there would be continuity in excellence and innovation in Bromford's service delivery to customers.

The four keys strands of the review were:

Project	Activities	Objective & Outcome
All Together Now	<ul style="list-style-type: none"> <li>• Adoption of a common housing management system</li> <li>• Standardisation of best practice processes across the business</li> <li>• Improved IT system for managing purchase orders and payments</li> </ul>	<ul style="list-style-type: none"> <li>• Savings from redundant systems</li> <li>• Less duplication and complexity plus improved workflow efficiency</li> <li>• Improved processing efficiency and control</li> </ul>
Single Operating Structure	<ul style="list-style-type: none"> <li>• A lean process approach to team re-structures</li> <li>• Alignment under a single brand and integration into single legal entity</li> <li>• Closure of one area office</li> </ul>	<ul style="list-style-type: none"> <li>• A headcount reduction of around 70 posts.</li> <li>• Streamline governance and reduce costs</li> </ul>
Value for Money Plan	<ul style="list-style-type: none"> <li>• Targeted savings from group procurement efficiency, focusing heavily on asset management</li> <li>• Tendering exercise on energy supplies</li> </ul>	<ul style="list-style-type: none"> <li>• Reduce costs: projects actually delivered annual savings of almost £3m of which £2m was reinvested into accelerated planned work</li> </ul>
Efficiency Challenge	<ul style="list-style-type: none"> <li>• Challenge to all discretionary expenditure using the test '<i>would you spend your last £1,000 on this?</i>'</li> </ul>	<ul style="list-style-type: none"> <li>• Reduce discretionary expenditure: delivered in conjunction with coaching to embed commercial behaviour, this challenge delivers year-on-year savings of £0.7m</li> </ul>

#### Outcome

Bromford's operating margin for the financial year ended March 2011 was 34% compared with 29% for the year ended March 2009. This extra 5% equates to growth of £6m.

Bromford has also set aside a designated reserve of £3m which is being used to fund the Group's additional social investment activities including working with customers to improve financial inclusion, create extensive apprenticeships and work placements, be a sub-contractor in the Work Programme as well as addressing worklessness through a range of other diverse methods.



### Case study: Soha Housing – achieving high quality for average sector costs

Established as an LSVT in 1997, Soha Housing now manages over 5,500 homes in Oxfordshire. In 2009 Soha Housing was the first housing association to achieve a 3 star equivalent rating for Value for Money and Resident Involvement in an Audit Commission Short Notice Inspection.

VFM is high priority at Soha Housing. It believes that to provide the best service for residents it is crucial to get the best value from its resources. Soha Housing aims to achieve a high quality service for average sector costs. To do this, Soha focuses not on the cheapest procurement but on procurement that provides best value in achieving an 'excellent' service to residents.

Vital aspects of Soha's approach include:

- Working to a two-year budget cycle which allows for better planning and longer-term reductions in costs
- Focusing on the surplus measure EBITDA (earnings before interest, taxes, depreciation, amortization) to provide a consistent measure of costs in relation to income and set improvement targets over a 5-year period
- Using HouseMark benchmarking to assess its VFM strategy, with the total management cost per unit being used as a key indicator
- Having procurement policies and procedures for each of the main procurement areas (planned repairs, responsive repairs, development and management/estate costs).

Soha Housing puts a high priority on clear, measurable objectives, so its VFM strategy 2011-14 targets include:

- To be in the top 50% of all housing associations on cost-efficiency measures
- To generate year-on-year efficiency savings of at least 1% per year
- To maintain repairs costs at below median costs per unit of all housing associations.

However, these quantitative targets are only there to support the ultimate aim of providing better value services that will either directly reduce costs payable or enable residents to receive better services for the same cost; or through the reinvestment of efficiency savings create new or improved services.

## Focus on customers

All three case study housing associations place a high value on excellence in customer service.

Bromford Housing Group's approach is heavily influenced by their 'one stop shop' customer feedback programme Your Voice (see box on page 18).

Affinity Sutton has recently established a single resident engagement structure across the whole group to scrutinise the new delivery structure (see box on page 18).

Soha Housing's Excellence Fund (see below) demonstrates how tenants are directly involved in making difficult choices around the setting of budgets and priorities (see box on page 19).

### Case study: Bromford Housing Group – Your Voice

In April 2009, Bromford launched Your Voice as its 'one stop shop' programme for customer feedback. Since its introduction, Bromford has spoken to 8,000 customers to journey map their overall customer experience using three key channels of communication:

- *Relationship checks:* Letters are sent out at 1, 3, 5, 7, 10, 15, 20, 25 and over 25 years to thank customers for being part of Bromford Housing Group, and to gather feedback about the quality of their home, neighbourhood, value for money and overall service.
- *Care Calls:* Telephone surveys are undertaken at various 'touch' points in the customer journey, for example, when they report a repair, make a complaint, or have experienced anti-social behaviour. Customers are questioned about their experience of the service received, and given opportunity to suggest how it could be improved.
- *Free Flow:* Picks up all other feedback from customers received through telephone, text, letter, social media, events and the website.

All this leads into identifying customer advocacy performance across all key elements of the 'Bromford Deal', the service offer to customers and is a major strategic KPI for the business. Performance is updated and communicated to colleagues in real time.

### Case study: Affinity Sutton – single resident engagement and scrutiny structure

Following its most recent merger Affinity Sutton has recently developed and introduced a single resident engagement structure. This has been a huge exercise and has involved reshaping existing resident engagement frameworks and unifying a single structure across the group.

#### The regional scrutiny boards (RSBs)

The structure consists of 3 regional scrutiny boards (London, South and South-west, and North).

The RSBs are sub-committees of the Affinity Sutton Board, where all of the performance monitoring will take place and be driven predominantly by tenants.

The RSBs are made up of a minimum of 50% residents and local interested parties'. Members of the RSBs are recruited/assessed according to the required skills sets. The RSBs meet quarterly to determine future priorities based on performance.

The primary focus of the RSBs will initially be on service delivery where the biggest gains can be achieved. In the longer term they could well expand to include VFM and efficiency, but the RSBs are starting on topics to build success and confidence.

#### Resident area panels

Feeding into the three regional scrutiny boards will be the 15 Resident area panels. These are locally established panels with elected chairs.

Affinity Sutton has increased the number of new residents becoming involved on panels by 35–40 per cent. Interest has been generated through residents' magazines and involving young people in web space development. Affinity Sutton has also worked to develop the skills and capacity of panel members.

#### National Council

There will be an annual two day national event for all actively involved residents to attend with the first National Council to be held in November 2011.

### Case study: Soha Housing – Excellence Fund

Soha Housing introduced their Excellence Fund in 2006, with the aim of encouraging staff to have imaginative ideas for improving service delivery and to achieve greater resident involvement in decision-making. The size of the Excellence Fund is decided annually by the board.

Decisions on which project applications are rewarded are made by a selection panel consisting of four staff members and four tenants. The criteria are:

- How will the project improve working practices?
- What are the projected benefits to tenants?
- How many tenants will benefit from the project?
- How does the project support Soha's excellence aims?
- What are the expected outcomes in relation to quality, value or savings?

## Taking staff with you

Whilst prioritising excellent customer services, all three case study housing associations acknowledged that staff are the primary vehicle through which efficiencies and improvements to services are delivered. As part of their respective approaches to driving change, all three housing associations had measures to prioritise communication with staff, with ways to link staff expectations with specific outcomes.

A further point made by all three housing associations is that their status as a value-based business is an important aspect of staff motivation and stakeholder support. Focusing change on the best way to meet the housing association's social objectives and values is therefore crucial.

### Case study: Affinity Sutton – linking staff bonuses to customer satisfaction

Affinity Sutton undertakes a quarterly survey of customer satisfaction. Staff bonuses are then linked directly to the survey results. Bonus payments are a maximum of 5% of salary: driven by targets based on a combination of customer satisfaction, financial goals and team-specific aims.

The bonus system has maintained a real focus on achieving good customer service for every member of staff, with high visibility and impact across the whole housing association.

## Managing the scale and pace of change

The two large landlords involved in the research, Affinity Sutton and Bromford Housing Group, felt that achieving efficiencies may be strongly linked to the scale of change, with those housing associations taking braver, wide-reaching changes reaping larger rewards. This experience however, was not echoed by the smaller association, Soha Housing, where incremental change has worked well.

Importantly housing associations should be clear about their destination, understand the size of the task required and the speed of change needed. Again there is no perfect 'one size fits all' approach to managing change to deliver efficiency. The size and speed of change should reflect individual circumstances and the degree of change needed to alter the culture or achieve other outcomes. This is particularly the case for mergers where it is not the scale of merger that produces cost savings, but how the organisation operates and changes as a consequence.

### **Mergers offer no guarantees of improvement**

The research found no automatic benefits for effectiveness and efficiency from mergers. However, the two larger case study housing associations, Affinity Sutton and Bromford Housing Group, are clear that growth brings with it significant opportunities for scale-related efficiencies, though these are not generated by increased size alone. Organisational transformation is necessary in order to benefit from, and maximise, efficiencies as the opportunities arise.

## **Comparison**

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The current diversity of the sector does have potential advantages. Not only is there a wide range of types of housing association, we have also seen considerable improvements in the ability of individual providers and the sector as a whole to analyse and compare their finances and performance. In particular, the development of increasingly effective benchmarking, recent analysis in *Social Housing*, and the more segmented financial analysis in the global accounts, all provide better information, allowing more effective analysis. This offers considerable scope for individual housing associations and the sector to be pro-active in developing realistic comparisons of VFM, helping to drive up performance.

The sector therefore needs to think hard about ways to use existing information to effectively build in challenges to both improve performance and to demonstrate that the improvement has been achieved.

It should be noted however that the TSA and HouseMark data demonstrate disparities in performance, some of which can be explained by, for example, the impact of working with communities experiencing deprivation. However this should not give an incentive to housing associations to withdraw from difficult neighbourhoods: many housing associations will wish to continue operating in areas experiencing different levels of deprivation because this reflects their values.

## **Sector-led improvement and scrutiny**

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Innovative ways of self-examination are already starting to emerge, for example the developing role of scrutiny by tenants and customers and resident-led self-regulation. However, for many housing associations scrutiny has traditionally focused on service delivery, rather than challenge to a housing association's values, priorities or budgets.

Further opportunities may exist around housing associations developing a more local focus and moving to a model of more localised, participatory budgeting or resident scrutiny of strategic priorities; though this would require housing associations to build capacity amongst residents to take on this role, and to allow enough time in their budget planning and preparation cycles for this to be done in a meaningful way.

See the case studies on page 21.

### Case study: Bromford Housing Group – customer influence and scrutiny

Bromford Housing Group's Customer Influence Groups are drawn from all those who rent, own or receive support in their home. Members work closely with the housing association to develop and improve services. The three key opportunities include:

- **Offer Groups:** these consist of customers and colleagues, who examine customer feedback on the main areas of service, including: home and design, neighbourhoods, contact and communications, value for money, homeownership and Bromford's Support. Feedback received through the Your Voice programme (see page 18) is used by the Offer Group to determine where improvement projects should be implemented.
- **The Customer Influence Group (CIG):** consists of customers and colleagues and meets quarterly. Its role is to agree and monitor projects suggested and implemented by the Offer Groups. CIG monitors projects to completion, and feeds back whether a project's service improvement aims have been met. The CIG may also request that the service is inspected.
- **Customer and Communities Board (C&CB):** one of seven board committees within Bromford's formal governance structure. It ensures customers have a voice in the way Bromford decides on services and how they will be delivered. Six of the twelve C&CB members are customers, with direct accountability to the Bromford Housing Group board. Members participate with all board and committee members in their annual planning day. Training and support is provided for all attending customers.

### Case study: Soha Housing's Co-Regulation model – tenants in the driving seat

Soha Housing has produced an innovative model of tenant influence and power aimed at supporting tenants to hold them to account at a strategic level. Soha is one of the ten national Co-Regulation Champions.

The co-regulation structure operates at three levels:

- **The Tenants Forum** is the central vehicle for holding Soha to account. It has a formal role in Soha's standing orders to monitor performance and help with decision-making. Their views are considered by the board in deciding policy, corporate plans and other decision-making.
- **The Tenant Inspectors** check Soha's performance against agreed standards and report the results to the forum.
- **The Tenant Scrutiny Group** challenges Soha on decisions made, plans and performance. They report to the forum and also directly to the board.

Residents are fully involved in making difficult choices around budget priorities. For example, over the last three years a group of residents has worked with directors in the budget process to make decisions on the management and estates budgets. The impact has been to prioritise expenditure in areas of most importance to tenants.

See the diagram in Appendix 3.

## 5 Scale, diversity and local delivery

### Issues of market diversity and scale

The housing association sector is varied. The majority of housing associations are small, owning under 100 properties. At the other end of the scale, larger housing associations owning over 2500 properties have the majority of the social housing stock: 90% of the stock is owned by 17% (272) of housing associations, whereas 61% (952) own 1 per cent.

It is important to stress the dominant position of two subsectors; large traditional providers managing in excess of 10,000 homes and stock transfer associations. Between them these two subsectors manage 78% of total homes and have 74% of both debt and turnover.

There have been debates about scale within the sector for some time, with some arguing that moving to a smaller number of larger housing associations would produce efficiencies through economies of scale, and others arguing that a continued 'mixed market' in different areas provides a necessary diversity of providers with different strengths.

This is hardly surprising as similar debates take place in relation to private sector firms. As long ago as 1937, Ronald Coase, in a famous management article,<sup>7</sup> argued that firm size is limited by transaction costs. Eventually, the cost of bureaucratic procedures within companies exceeds the cost of transacting with outsiders to do the same thing. In the 1970s, Oliver Williamson<sup>8</sup> wrote about 'diseconomies of scale': economies which accrue with increased scale eventually tail off and are submerged by disadvantages, particularly inertia and loss of clarity.

Commentators such as McDonald<sup>9</sup> have argued that smaller organisations can respond better to change because they have flatter decision-making structures. Others argue that a larger organisation's diversity of resources and specialisms make them more flexible in implementing change.<sup>10</sup>

### What do the TSA and HouseMark data show for the housing association sector?

Analysis undertaken by the TSA did not generate any strong evidence on economies of scale for general needs stock resulting in lower costs, either through group structures or size of entities. The TSA report said that:

*'The absence of strong evidence on economies of scale for General Needs stock in unit costs data is surprising. One may rationally expect larger organisations to achieve economies of scale in a number of areas such as support functions, procurement, development and through diversification of risks.'*

There was evidence of returns to scale for shared ownership, suggesting that there might be benefits from scale for specialised areas, however the scale of non-social stock ownership appears to have no discernible effect on costs.

HouseMark looked at the differences between the big developers and the other housing associations in their sample (see appendix one). They found that the big developers spend slightly less on repairs than small/non-developers. There is no significant difference between housing management costs per property for big developers versus small/non-developers

HouseMark did however find that the larger the stock size the less likely a housing association is to be 'best' and that, for both housing management and repairs, smaller or non-developing housing associations have better performance scores than housing associations with large development allocations.

7 'The Nature of the Firm', published in the journal *Economica*

8 *Markets and Hierarchies: Analysis and antitrust implications* (1975) Oliver Williamson, Free Press, New York

9 *Learning to change* (1995) S.Macdonald, Organisational Science

10 *Organisational strategy – an ecological perspective* (1991) W. Boeker, Academy of Management journal

This could be because the lack of focus on development allows smaller housing associations to concentrate more intensively on service delivery. Alternatively, it might suggest that service delivery is better undertaken in smaller organisational units and at a local level.

Whilst this all suggests that there is little evidence that larger housing associations are benefiting from economies of scale or better performance, the two larger developing housing associations that took part in this project, Affinity Sutton and Bromford, did identify some clear advantages from their size. They are:

- In a better position to raise funds at competitive costs
- Able to tackle both larger projects and a range of activities
- Able to pay the necessary salaries to employ high quality staff, particularly in development and finance roles where competition with the private sector is high
- Able to absorb shocks in a way that smaller housing associations might not
- Have the scope to make significant impacts in the areas in which they work
- Able to trial initiatives in one part of the business before roll out
- Have advantages for procurement, systems investment and colleague development investment.

It should be recognised however that both had to transform their organisations to achieve these benefits of scale. This echoes some commentators' views of private sector activity. In *Scale Effects, Network Effects, and Investment Strategy*, Willy Shih argued that some of the great business disasters of the dot.com bubble were companies that scaled up their infrastructure without working through the consequences.<sup>11</sup>

### Scale alone does not automatically provide efficiency

Analysis of both HouseMark and TSA data did not provide any statistical evidence of economies of scale to be achieved through size, and that scale alone does not have automatic efficiency benefits.

Analysis found no evidence that larger housing associations benefit from economies of scale or better performance. However, whilst there is no optimum size to achieving efficiencies through economies of scale, case studies show that scale might be important if an organisation can make the necessary changes in its culture and approach to achieve any scaling effects or benefits from growth.

This is particularly the case for mergers where it is not the size of merger that enables cost savings, but how the organisation operates and changes as a consequence. Indeed, there may be significant opportunities for scale-related efficiencies, but organisations have to transform the way they are structured to benefit from them.

### Case study: Affinity Sutton – using scale to tackle wider community issues

Affinity Sutton has set up a charitable investment fund designed to generate returns to fund community projects. The fund was established by setting aside part of their surplus in 2009/10. With a further donation in 2010/11, the foundation now has an endowment of £53m.

Affinity Sutton currently invests £2-3m in communities each year. The fund enables these activities to be clearly defined and to be sustainable over time. Current focus is on the following three areas:

- Employment and training
- Financial inclusion
- Improving neighbourhoods and health.

The charitable investment fund is administered by a separate community foundation. The foundation determines the strategy for utilising funds, which for transparency are separately identified in the group accounts.

Affinity Sutton has the option of topping up the fund in future years.

<sup>11</sup> *Scale Effects, Network Effects, and Investment Strategy* (2011) Willy Shih, Harvard Business Review

## Scale and local impact

Malcolm Gladwell in *The Tipping Point*<sup>12</sup> has highlighted the work of anthropologists who argue that 150 people is the ideal size for any group trying to accomplish any outcome. This argument is based on the theory that the human brain can handle relationships in groups of this size, but that above this, effectiveness tends to be sapped by procedures, rules and bureaucracy. These weaken morale and enthusiasm and lead to sub-optimal performance.

This suggests that even for large housing associations there is a need to think hard about how the organisation is structured. Jerry Benson, Managing Director at Serco has said that:

*'Serco is a global services company and we employ around 70,000 people worldwide. We turn over about £4bn a year. We subdivide most of our businesses into business units and then contracts, and those contracts are almost entities within themselves. Success or failure is associated with that contract structure and how it grows. As long as you are focusing at that level on the right business issues, then big or small is almost irrelevant.'*

The CIH report *Is big really best – or can small and friendly deliver?* argued that housing associations have to think about economies of scale in different ways for different functions. It suggested that housing management might be better undertaken in an optimal range of 1,000-5,000 units whilst stock investment might have a much larger optimal range of over 5,000 units.

In re-examining these arguments, Soha Housing (also a developing housing association) made the case that having a clear local focus and concentration of stock has real benefits. Part of the value of operating in a tight geographical area is being able to establish and maintain strong local relationships, while retaining a comprehensive awareness of local housing and labour markets/contractors. The benefits feed through into more effective and efficient cost management.

The HouseMark data analysis provided some support for this view. It showed that LSVTs, with their strong local concentrations of stock, spend less on housing management than traditional housing associations (although this may also be explained by inherited lower costs from the pre-transfer landlord). LSVTs also have significantly better scores for housing management performance and for repairs. The TSA analysis found that beyond their early years, there was no cost differential between LSVTs and other associations.

For larger housing associations, dispersed over many local authority areas, there may be benefits in the delivery of localised services through teams that serve local areas. They can offer simpler processes, with local decision-making powers in order to be responsive to local issues and priorities. However, just being small or delivering localised services on its own, may not be sufficient to deliver 'best'. Housing associations need to be underpinned by strong values and effective leadership.

### Scale and local impact

Both case studies and data analysis support the argument that scale is not as important as other factors; in particular a strong localised focus may have benefits whatever the size of organisation.

## Understanding the operating environment and local markets

All three case study housing associations stressed the importance of developing strategies based on a clear understanding of the operating environment. In particular they stressed:

- A clear headed analysis of market conditions

<sup>12</sup> *The Tipping Point* (2000) Malcolm Gladwell



- A business impact assessment
- Clarity about how customers' views influence the strategy
- The involvement of a range of stakeholders.

They were also clear that their strategies were based on this analysis. This may seem obvious but for many housing associations the requirements of regulatory standards and inspection have been paramount in their thinking. Given the regulatory changes which are taking place at present, if housing associations do not develop their own effective analysis and strategies, they will struggle to be effective.

Some housing associations, which will be developing less or not at all, will face significant issues about how to deal with capitalised overheads and potentially increasing surpluses. The sector may also demand greater clarity and transparency around how non-developing housing associations use their surpluses. In addition, some housing associations are choosing not to continue to develop with HCA finance or to develop in different ways, possibly moving into new markets created by some of the provisions of the Localism Act.

Increasingly, landlords are employing asset management policies to release resources to help develop new housing without grant and to pursue other business opportunities. To be effective in such an approach, landlords need the knowledge and skills to evaluate:

- The long-term performance of their property portfolio
- The performance of each individual property
- Local market conditions.

### Increasing flexibility

For housing associations considering moving into new markets, slimming down their organisation and creating increased flexibility may be more important than aiming to grow so as to get economies of scale.

## Merger activity and trends

With the increased pressures on costs referred to above, it might be expected that there would be a significant increase in merger activity over the next few years. However over the last three or four years mergers have been less a feature of the sector than during the early and mid-2000s, and current counter-pressures may force housing associations to think hard before considering merger. Problems of re-pricing debt where loans become available for review (as they do in the event of merger) are now seen as the principal challenge.

Some mergers have involved better housing associations absorbing housing associations with problems, actively strengthening the viability of the sector. Many housing associations who merged on the basis of group structures have sought to 'digest' their mergers by simplifying and rationalising their structures to consolidate gains, as is the case with both Affinity Sutton and Bromford in this study.

The report *The Bigger Picture*<sup>13</sup> found that only 50% of mergers had actually measured the efficiency savings they had achieved in relation to their projections or expectations. It also demonstrated how mergers can absorb energy which might be better devoted to other activities, unless there is clear evidence that the merger is going to result in significant economies of scale or better services to tenants.

<sup>13</sup> *The Bigger Picture* (2006) CIH

## Rationalisation activity and trends

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The need to develop a clearer understanding of costs and to decide the best use of their portfolio (down to the level of individual properties) requires landlords to make explicit decisions about whether they want to keep operating in a particular area, and whether their current spread of stock makes economic and management sense.

One important option available to housing associations is to transfer stock which does not fit in with their overall aims, or where transfer would contribute directly to their wider aims such as:

- Improved service delivery or community engagement
- Improved local decision-making
- Improved cost efficiencies
- Improved partnership working.

In recent months we have seen a significant upsurge in rationalisation activity. Two examples are:

- Home Group has prioritised the areas in which to operate, selling more than 10% of its properties and raising £100 million for business development
- Arcadia Housing Group is reducing the number of local authority areas where it works from 37 to 9, to restructure its operation to make major savings.

The need to work closely with local authorities and understand local markets may be a significant factor in housing associations choosing to focus on fewer areas, thus leading to some larger housing associations looking to transfer surplus stock to more locally based ones.

TSA research found some evidence that general needs stock held in dispersed pockets of 100 or fewer per local authority area are associated with higher lettings costs. However, within HouseMarks cost/performance model this factor was not so significant, compared to other factors such as: deprivation, region, and organisational type.

### Merge or rationalise?

Today as housing associations look to consolidate their organisations they have a clearer idea about what works and what does not. Many, as a result of the financial pressures of recent years, have become more adept at understanding and managing both their financial and cost performance.

New cost pressures might therefore be expected to force them to think very hard about the potential benefits and opportunity costs of merger. Indeed these pressures are already leading some housing associations to focus both on rationalising their stock and on restricting the geographical spread of their activity.

## What lessons can we draw about scale?

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Overall this research suggests a number of lessons on scale in terms of costs and performance:

- Scale in itself does not provide automatic efficiency benefits. There may be significant opportunities for scale-related efficiencies, but organisations have to transform the way they are structured to benefit from them
- Housing associations contemplating merger need to be satisfied that:
  - the potential for benefits is there
  - they can make the organisational changes to realise them
  - the opportunity costs involved are worth incurring
- A clear local focus and concentration of stock appear to have real benefits in terms of both cost and service delivery performance

- Rationalising stock to focus on fewer areas may have benefits for some housing associations operating over wide geographical areas
- For housing associations wanting to move into new markets, flexibility may be more important than scale
- In terms of achieving VFM for housing associations of all sizes there is an imperative to focus on understanding:
  - organisational costs
  - their markets
  - the long term performance of their property portfolio.

### **The findings remain the same**

The most significant findings from this work echo those of the previous CIH report *Is Big Best – or does small and friendly deliver* (2005) which looked closely at these same issues:

- There is no evidence that size, better quality services and lower costs are linked
- For housing associations to be effective, it is more important that they are clear about their values and the outcomes they want, and have effective management to achieve them.

## 6 Future options, diversification and developing into new markets

### Diversification: More specialism or contracting out?

We have seen above that local presence and concentration of activities might be at least as important to effective housing management delivery as scale. Might there be some logic therefore to individual housing associations specialising in different functions?

Traditionally housing associations see themselves as encompassing development, ownership, capital works and customer services in one body. However, in other regulated sectors such as the utilities these are seen as separate functions, with differing skill sets which are not combined within one organisation.

The CBI produced a report in 2010 – *Improving homes, improving lives*<sup>14</sup> – it argued that competition could be used more effectively to improve services and efficiency. The Cave Review<sup>15</sup> also argued that separating the roles of developer, owner and manager could:

*‘...open up a range of ways in which housing associations with available financial capacity can become the owners of new homes developed by others’*

It went on to argue that:

*‘The review considers that there are substantial benefits to be achieved by making it easier for these different roles to be separated. The best developer may not be the best manager and vice versa.’*

There are already established markets in repairs, cleaning services and estate repairs (although there is a trend among housing associations to bring repairs and maintenance services back in-house). There are also examples of outsourcing functions such as financial services and automated rent payments. However, there have still been few attempts by housing associations at outsourcing customer services either as a whole (or in part).

Examples of housing associations entering into management agreements with other housing associations are still limited. This is partly due to the ownership of assets being the key to raising funds for development. Some capacity can therefore become ‘trapped’ if the smaller organisation focuses on housing management alone. The TSA data found no evidence of whole organisation cost savings where contracting out has occurred. However, the HouseMark analysis found housing associations with an outsourced repairs function are more likely to be ‘best’ for repairs than those with an in-house DLO.

Though cost implications regarding VAT may be a key factor preventing more housing associations from considering management agreements, outcomes of the current review by HM Revenue and Customs (looking at whether not-for-profit organisations should be excluded from paying VAT when they team up to shared services) may open up new opportunities for joint working in the future. This may be strengthened by the Chancellor’s Autumn Statement 2011 that announced VAT exempt bodies such as charities that share services between them will be subject to a VAT exemption (pending consultation in 2012). Proposed changes could bring about significant savings for the housing association sector, for example where services such as back office functions are shared.

<sup>14</sup> *Improving homes, improving the lives – using competition for better social housing* (2010) CBI

<sup>15</sup> *The Cave review of social housing regulation* (2007) CLG

## Business models

Earlier chapters have shown options of how housing associations may structure themselves, both now and in the future, which could include:

- Merger activity continues but with greater transparency over how the objectives of the merger are achieved and delivered post merger
- Collapsing of group structures to yield financial savings and to improve communications and more joined-up working
- The possibilities of 'going local' through smaller, localised teams, serving local areas, with simpler processes and more local decision-making influence
- Rationalising stock to have clearer focus on being effective in core areas.

This will mean housing associations making choices about the markets where they wish to operate. Over the last year a number of different studies have suggested options for housing associations. If we look at these we can see some potential models which illustrate the options which housing associations might consider.

Option – or the organisation's main focus	Relevant studies	Focus	Issues
<b>A social landlord</b>		<ul style="list-style-type: none"> <li>• Focus on social housing for those who most need it and retaining existing offer to tenants</li> <li>• Limited development</li> <li>• Surpluses grow and borrowing capacity may be 'underused'</li> </ul>	<ul style="list-style-type: none"> <li>• Need to make decisions about how to use surpluses and spare capacity and how far these might support business development and/or meeting wider non-housing needs of tenants</li> </ul>
<b>A non-profit market landlord</b>	<i>Widening the rental housing market, CIH/L&amp;Q; Housing people, financing housing, Policy Exchange</i>	<ul style="list-style-type: none"> <li>• Focus on providing good-quality rented and intermediate housing products for a range of customers</li> <li>• Possible move to 'Equitisation' or mutual status</li> </ul>	<ul style="list-style-type: none"> <li>• Need to take risks in terms of new products</li> <li>• Must be prepared to compete with the private sector</li> <li>• Potential for institutional investment</li> </ul>
<b>Community partnership</b>	<i>At the crossroads, Respublica</i>	<ul style="list-style-type: none"> <li>• Priority is building communities rather than building homes</li> <li>• Community investment and regeneration become core business</li> </ul>	<ul style="list-style-type: none"> <li>• New risks arise from taking on different social products</li> <li>• Investment moves away from directly meeting housing need</li> </ul>
<b>Social marketeer</b>	<i>Making housing affordable, Policy Exchange; Housing Poverty: From Social Breakdown to Social Mobility, CSJ</i>	<ul style="list-style-type: none"> <li>• Deal increasingly in short-term starter tenancies linked to a contract between the tenant and the landlord which focuses on the tenant moving along progressive housing pathways as their circumstances change, with regular tenancy reviews</li> <li>• Develop a 'social market' where tenants who are prepared to pay more may enjoy a wider choice or a faster offer</li> </ul>	<ul style="list-style-type: none"> <li>• Model may not work for the most vulnerable or older people</li> <li>• Could create a very short term view of the area by tenants</li> <li>• Would need considerable resources to support tenants into housing pathways</li> </ul>

In considering the options, housing associations need a clear understanding of their starting point. Housing associations will need to be clear about their own strengths, and develop approaches which take into account – but are not driven by – current policy trends, and build on where they are now.

## Options for creative partnerships

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Soha Housing is currently part of a development consortium of smaller and medium size housing associations for whom Bromford is the lead developer. This is currently a common form of relationship. However, in the future we may start to see more creative housing management partnerships emerging, such as:

- Joint service centres
- Housing associations sharing void properties in order to transfer tenants at the end of a fixed-term tenancy or where the new housing benefit under-occupation criteria affect tenants.

The sector may start to witness new types of partnerships with developers which hold land, or private investors who see a potential long-term return on capital from rented housing, with housing associations taking on roles as developers and managers but not owners.

London and Quadrant are quite openly disposing of the more complex aspects of their business, such as sheltered housing and care and support, whereas other housing associations, such as Bromford Housing Group, are focusing on care and support as a key part of their way forward (see case study below). Soha Housing is clear that it is important to get their core business right, before engaging with wider community-focused activities.

### Case study: Bromford Housing Group – moving forward

Bromford Housing Group is looking to broaden and enrich their 'support' offer by creating a single group vehicle for delivering their full range of social investment activities.

Working on the premise that there will be a reduction in their existing Supporting People (SP) contracts during 2012, Bromford Housing Group is preparing to tender for the new services that will be commissioned in their place, with the aim of seeing the scale of their housing-related support activity increase as a result, albeit with a broader remit, new service models and at more competitive prices.

Bromford Housing Group will also seek to offer employment, skills and training opportunities and work with community-based enterprises to help build their resilience and skills. This will involve working with a number of prime contractors to determine how they can contribute to delivering part of the government's Work Programme.

It is the intention to focus energies on local authority areas where activities will have the biggest impact, and where Bromford Housing Group tends to have the greatest concentrations of stock. It is expected that the make-up of their service portfolio will change as local decisions about what services will be commissioned, and what prices will be paid, take effect.

## Using surpluses: maintaining housing associations' values and services

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Housing associations are a successful example of what can be achieved by value-based, not-for-profit businesses. However, that very success, and the fact that they have been supported by government in achieving it, can lead to significant expectations being placed on them, including how they might use their financial capacity both now and in the future.

Although this is most clearly apparent in the government's Affordable Rent programme, it is nothing new. The Cave review for the last government said:

*'Housing associations have significant levels of unused financial capacity and Government would like to utilise this to contribute to the provision of affordable housing. But new supply is not the only proper use of surpluses and those with a special interest in community development or support services or higher housing standards or higher quality services are all eyeing the same pot of potential resources. Competing demands on a finite pot is always a source of potential conflict.'*

Housing associations may be making surpluses and have capacity, but there are limits to the use of that capacity. A recent report has shown that Affordable Rent in itself will *absorb large amounts of the housing association sector's financial capacity*.<sup>16</sup> This inevitably reduces the sector's ability to respond to different policy stimuli, such as the Community Right to Buy and initiatives to tackle worklessness.

Many housing associations are already involved in wider activities to support their investments in the communities in which they work, such as Affinity Sutton's Community Fund (see case study on page 23) and Bromford Housing Group's focus on social investment activities to tackle worklessness (see case study below). This is however in contrast to those housing associations not developing or investing in wider community investment activities, which may come under increased pressure to explain how any surpluses are being used. Housing associations therefore need to make clear decisions about how they achieve the best VFM whilst pursuing their values and priorities.

### Case study: Bromford Housing Group – tackling worklessness

As part of Bromford Housing Group's social investment values it strives to create opportunities and deliver added-value services that help make a positive difference to customers' lives, and increase opportunities for independence.

The first stage of Bromford's apprenticeship programme saw five apprentices recruited in November 2010 who were tenants or tenants' children. Funding was originally through the Future Job Fund (FJF) in partnership with the NHF and Third Sector Consortium. However as the FJF programme will no longer receive government funding Bromford Housing Group will deliver its own programme, known as the O4E programme, for up to 15 placements, which will feed directly into the 2011/12 apprenticeship programme.

By linking the O4E and apprenticeship schemes Bromford can provide approximately 100 internal work opportunities for residents over the next 4 years which will progress the organisation's aims to build the skills, capability of its customers and provide better access to a wider range of employment opportunities. With other training and development programmes included Bromford aims to provide 200 work opportunities for residents within the organisation. This will be funded by Bromford's Social Investment Budget for the next five years.

### Unlocking capacity

In the future, unlocked capacity within the sector may continue to be retained by a number of housing associations which either choose not to (or are unable to) develop, whilst many developing housing associations are reaching the limits of their own capacity. The increased pressure to unlock capacity within the sector may lead to increased focus on how non-developing housing associations are using their surpluses – doing nothing may no longer be an option. New arrangements may start to emerge where housing associations trade their surplus capacity in exchange for managing developing housing associations' properties or functions.

<sup>16</sup> *Where next? Housing after 2015* (2011) L&Q/Price Waterhouse Cooper

## Fit for purpose: fit for tomorrow

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All three case study housing associations looked at for this report, have been clear about the importance of assessing their strengths and weaknesses, understanding their markets, and have developed robust approaches as to how they are going to be effective in meeting their priorities.

Housing associations will have to make hard choices about the balance between using resources to:

- Develop homes
- Tackle wider social issues
- Green their existing stock
- Generate surpluses to cover potential risks
- Improve services for existing tenants.

The move away from detailed regulation of service delivery means that housing associations have to be clear about their priorities and how to deliver them. Until now, services have often been designed to meet the requirements of regulatory standards and inspection, rather than being the best way to deliver VFM services to customers.

For some housing associations this will require challenging decisions as to where their priorities should be. Housing associations will have to be much clearer about their strategic considerations, for example understanding:

- What is the business really good at?
- Where is the business losing money?
- How do we compare to our competitors, do we know who our competitors are?
- Where is the business most effective?
- Who are our best relationships with?
- Are we making a difference?

In particular, housing associations will have to be clear about:

- How far responding to the changes outlined in chapter one meets with their core purpose and values
- How they can build on the sectors success in engaging with tenants and ensure that they fully take tenants' views on board when assessing changes that are taking place
- How far they engage with filling potential gaps in provision of services to their tenants created by the withdrawal of other public funding.

## More freedom and responsibility?

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Several recent reports<sup>17</sup> have argued for housing associations to be given a wider freedom to manage their assets and set rents. One of these, *Appreciating assets*, argued that:

'The key issue is not to have centrally driven targets but to enable and facilitate housing associations to manage their assets in the most effective way to meet their aims. Giving housing associations the freedom and clear responsibility for doing this could drive efficiency, produce more homes and allow better analysis of local markets.'

Our case studies have shown the positive ways that housing associations can manage their businesses. These could be advanced further if they had more control over their business decisions.

Housing associations have to recognise however that there are responsibilities attached to greater freedom.

<sup>17</sup> *Appreciating assets* (2011) CIH and Savills; *Where next: Housing after 2015* (2011) London and Quadrant / PricewaterhouseCoopers; *At the crossroads* (2011) Republica



Comparison and shared learning only take you so far. If housing associations are not being effective at providing value services then they are harming the reputation of the sector as a whole. Perhaps it is time for maturing housing associations to challenge themselves, say 'where next?' and own more of the agenda themselves in the interests of the sector and the communities which they are pledged to serve.

This might mean agreeing that housing associations that are not producing VFM should subject themselves to corrective action. We saw earlier how important it is that housing associations properly benchmark their costs performance and interrogate why they are different from others. Housing associations who have a continuing poor VFM comparison with similar housing associations might be partnered with successful housing associations.

This could be taken further with arrangements such as those housing associations, whose performance has not improved from partnering arrangements, volunteering to outsource the management of their stock or give their tenants the option of switching provider.

The key questions which housing associations therefore need to ask themselves are:

- Just how much more efficient could we be?
- How can we best deliver services that provide genuine VFM?
- How can we build in genuine challenge to drive this forward?

## Appendix one: HouseMark – technical note on analysis

### Purpose

This analysis makes use of HouseMark and TSA data to investigate the research question ‘Is big really best?’

### The dataset

The dataset relates to 297 English housing associations who submitted data for the 2009/10 financial year to HouseMark for its cost, performance and satisfaction benchmarking. Certain variables from the HouseMark dataset were analysed alongside some variables provided by the TSA.

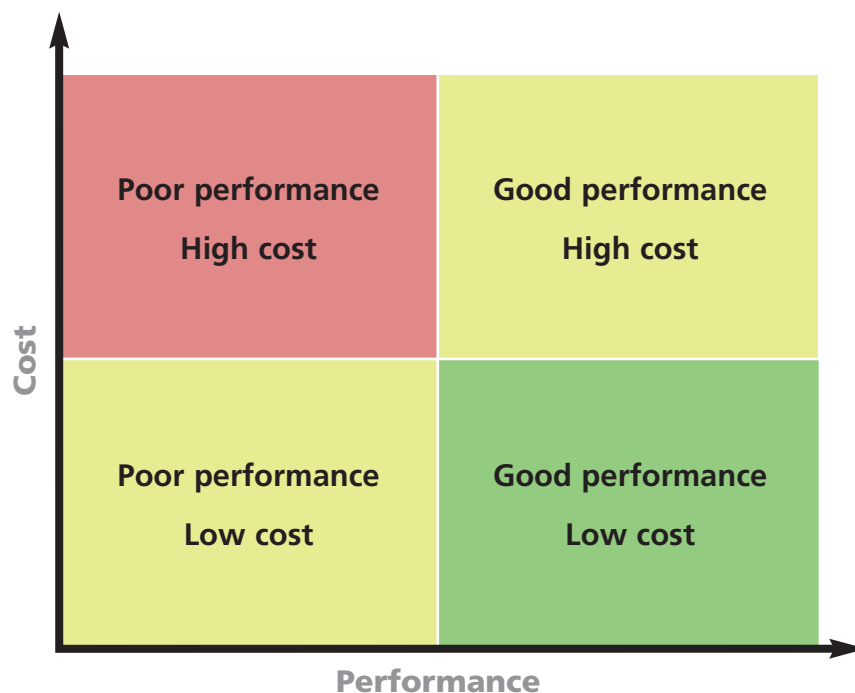
The HouseMark cost, performance and satisfaction measures used in this analysis relate to general needs and housing for older people stock which is managed by the housing association.

### How was ‘best’ defined?

For the purpose of this research project, ‘best’ has been defined using a combination of cost measures and performance indicators which are collected and rigorously validated by HouseMark.

We have based our determination of ‘best’ around a quadrant plot of performance versus cost, where housing associations lying in the ‘above median performance, below median cost’ quadrant (coloured green in the diagram below) have been labelled ‘best’ for the purpose of this analysis. Therefore each housing association can be either ‘best’ or ‘not best’ creating a binary variable.

**Chart 1: HouseMark quadrant plot of performance versus cost**



The analysis deals with housing management costs and performance separately from repairs costs and performance. This separation reflects a belief held by colleagues specialising in HouseMark's benchmarking services that the drivers for low costs and high performance could vary between housing management activities and repairs activities.

## Housing management activities

The cost element of the overall housing management binary variable is the cost per property of housing management activities including rent arrears and collection, lettings, tenancy management and resident involvement. The cost per property is made up of employee costs and non-pay costs, and covers direct costs and relevantly apportioned overheads.

All costs in HouseMark's benchmarking dataset are subject to an area cost adjustment (ACA) which adjusts costs downwards in London and the South East to allow for the higher costs experienced in these regions.

The performance element of the overall housing management binary variable is calculated by combining the performance indicators shown in Table 1. Each housing association's score for a particular performance indicator has been converted to a 0-100 scale according to where the housing association is ranked on this indicator relevant to all other housing associations in the dataset. The higher up the rankings, the higher the score on this scale. The converted scores are then combined by taking the weighted average of the performance indicators shown in Table 1, applying the weight shown in the final column of the table. The indicators and their weightings were selected following analysis undertaken by HouseMark in the summer of 2011 into the reliability, correlations and influences of 84 performance indicators collected on an annual basis.

**Table 1: Indicators for the performance element of housing management**

Indicator name	Weighting
Rent collected (excluding current arrears brought forward)	1
Rent arrears – current tenant arrears as% of rent due	1
Rent arrears – former tenant as% rent due	1
Rent arrears – gross arrears written off as% rent due	0.5
Relets – average number of days taken	1
Rent loss – amount due to voids as% of rent due	1
Units vacant and available at year end per cent	0.5
Units vacant and unavailable at year end per cent	0.5
Tenancy turnover	0.5
Satisfaction – % satisfied with services provided	1
Satisfaction – % satisfied views are being taken into account	1
Rent arrears – tenants evicted as a result per cent	0.5
Service delivery boards – members who are residents per cent	0.5

## Repairs activities

The cost element of the overall repairs binary variable is the cost per property of repairs activities covering responsive repairs, void repairs, major works and cyclical repairs. As with housing management activities, the cost per property is made up of employee costs and non-pay costs, and covers direct costs and relevantly apportioned overheads.

All costs in HouseMark’s benchmarking dataset are subject to an area cost adjustment (ACA) which adjusts costs downwards in London and the South East to allow for the higher costs experienced in these regions.

The performance element of the overall housing management binary variable is calculated by combining the performance indicators shown in Table 2. The method for combining the scores is the same as described for overall housing management performance in Part 3.1.

**Table 2: Indicators for the performance element of repairs**

Indicator name	Weighting
% of all repairs completed within target time	1
Satisfaction – % satisfied with repairs and repairs	0.5
Decent homes failure per cent	0.5
SAP rating of self-contained dwellings – average	0.5
Satisfaction – % satisfied with overall quality of home	0.5

## Characteristics variables

HouseMark collects some data on housing associations’ characteristics. To create a fuller dataset, HouseMark’s variables were supplemented with some prepared by the TSA for their own research purposes,<sup>18</sup> plus a variable on large scale developers derived from data tables produced by Social Housing magazine on HCA funding allocations.<sup>19</sup>

**Table 3: Characteristics of housing associations**

Variable name	Description	Data source
Gn/hfop stock	Managed general needs units plus managed housing for older people units	HouseMark
Hfop ratio	Ratio of managed housing for older people units to managed general needs/housing for older people units	HouseMark
Type	LSVT or traditional	HouseMark
LSVT dummy variables	<p>LSVTs are grouped according to whether:</p> <ul style="list-style-type: none"> <li>• They had been a stock transfer association for less than 7 years</li> <li>• They had been a stock transfer association for between 7 and 12 years</li> <li>• They had been a stock transfer association for more than 12 years</li> </ul>	TSA

<sup>19</sup> Technical paper: *Understanding unit costs of housing associations – regression analysis* (March 2010) TSA

<sup>19</sup> *Special report: NAHP grant allocations 2009/10* (Sept 2010) Social Housing magazine

**Table 3: Characteristics of housing associations – contd.**

Variable name	Description	Data source
Region	HouseMark allocated region for the association. Each housing association has only one region	HouseMark
Big developer	Whether or not the HCA allocation for social rent exceeded £10 million. If one member of a group receives the allocation, that member and all other group members in the dataset are defined as 'big developers'	HouseMark, based on Social Housing data tables for HCA allocations
Weighted Index of Multiple Deprivation	Weighted Index of Multiple Deprivation per annum. Constructed by TSA on the basis of lettings per Lower Super Output Area (LSOA) (from CORE data) and the Index of Multiple Deprivation (2007) for each LSOA, multiplied by the average General Needs stock as a proportion of average total social housing stock in the current and previous year.	TSA
Dispersal pockets	Proportion of general needs/housing for older people/supported stock owned in pockets of less than 100 per local authority, multiplied by the share of general needs/housing for older people/supported of all social housing stock.	TSA
DLO	Whether or not the housing association has a Direct Labour Organisation for its repairs service	HouseMark
Overheads	Overheads as a percentage of adjusted operating costs. Adjusted operating costs are operating costs less reconciling items. Alternatively adjusted operating costs can be expressed as employee costs (direct staff and overhead staff) plus non-pay costs (direct and overheads).	HouseMark

## The models

Whether or not a housing association makes it into the 'best' quadrant of Chart 1 is driven by a number of factors. Regression modelling is a statistical technique which allows the effects of a particular factor to be isolated while all other factors in the model are held constant.

In a regression analysis, the relationship between a dependent variable and one or more independent variables are tested. In this study, we are examining housing management and repairs separately. The independent variables are the characteristics of associations listed in Table 3, and these particular variables are examined in both the repairs and the housing management model. The dependent variable is whether or not an association is 'best' according to the quadrant chart described in section 3. Separate dependent variables are examined for the housing management and repairs models; the method for defining these two variables are the same but one relates to housing management costs and performance, and the other relates to repairs costs and performance.

As the variable we are particularly interested in modelling is a binary variable (a housing association is either 'best' or it is 'not best') a particular form of regression analysis known as logistic regression has been used. This relates the *probability* that a housing association is 'best' to the independent variables.<sup>20</sup>

<sup>20</sup> In this logistic regression, the dependent variable is the natural logarithm of the odds ratio ( $p/(1-p)$ ) where  $p$  is probability.

Various logistic regression models were fitted to predict whether a housing association would be 'best' according to the HouseMark and TSA variables relating to the characteristics of housing associations. The levels of correlations between pairs of independent variables were also examined and where this presented a problem to the model, one of the two related independent variables was rejected. Diagnostic tests were applied to select preferred models for housing management and repairs separately. Readers familiar with standard regression models would look to the adjusted R-squared value as a measure of how good the model is at predicting the variable of interest. This measure has no meaning in logistic regression although there are alternatives. For the purpose of this analysis, the main alternative measure of model performance that has been used is the receiver operating characteristic (ROC) curve,<sup>21</sup> specifically the area under the curve (the ROC score). If the model were no better at predicting which housing associations were 'best' than a purely random guess, the curve would be a straight diagonal line and the ROC score would be 50 per cent. For an ideal model which perfectly predicted which housing association was 'best' in every case, the ROC score would be 100 per cent.

## The findings

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### *Drivers of 'best' on housing management*

The full model containing all characteristic variables achieved a ROC score of 86.6 per cent.

The preferred reduced model contained only the LSVT dummy variables and the weighted index of deprivation, and still achieved a ROC score of 82.8 per cent.

A significant finding is that LSVTs are more likely to be 'best' for housing management than traditional housing associations. Furthermore, when the LSVTs are broken down in bands according to time since stock transfer, it is the LSVTs who transferred over 12 years ago that are most likely to be in the 'best' quadrant for housing management. They are closely followed in likelihood by LSVTs who transferred less than 7 years ago. The 'middle aged' LSVTs are significantly less likely than other LSVTs to be 'best' for housing management.

For example, for associations with median levels of deprivation, the probability of being 'best' as predicted by the preferred reduced model is 9% for traditionals, 46% for 'middle aged' LSVTs, 57% for 'young' LSVTs and 61% for 'older' LSVTs.

Increasing the level of **deprivation** reduces the likelihood of being 'best' for housing management. For example, for an 'older LSVT' the probability of being 'best' as predicted by the preferred reduced model is 61% if the stock is in areas with median levels of deprivation (IMD score of 30); this probability reduces to 46% if the stock were to move to areas with the worst quartile levels of deprivation (IMD score of 41).

### *Drivers of 'best' on repairs*

The full model containing all characteristic variables achieved a ROC score of 84.7 per cent.

The preferred reduced model contained only the characteristic variables overheads, region, weighted index of deprivation and DLO, and still achieved a ROC score of 83.5 per cent.

The **overheads** variable was particularly important in explaining whether or not a housing association was 'best' for repairs. As the percentage of adjusted operating costs which are overheads increases, the probability of being in the 'best' quadrant increases. For example, for a housing association without a DLO in the East region and with the median level of deprivation, the probability of being 'best' as predicted by the preferred reduced model is 33% for median overheads; this probability increases to 57% for upper quartile overheads.

<sup>21</sup> A ROC curve is achieved by plotting false positive rates against false negative rates.

Regionally, housing associations operating predominantly in London are least likely to be 'best' for repairs, followed in increasing likelihood by those in the South West and then the South East. At one extreme, for housing associations in London without a DLO and the median level of deprivation, the probability of being 'best' as predicted by the preferred reduced model is 4%. At the other extreme, for association in the North East without a DLO and median weighted index of deprivation, the probability of being 'best' as predicted by the preferred reduced model is 53%.

The variation by region occurs despite HouseMark's area cost adjustment (ACA) being applied to costs in graduated bands from inner London to outer London to the rest of the South East. It is possible that the reductions applied to costs by HouseMark's ACA<sup>22</sup> to London and the South East are not extreme enough to take account fully of variations in construction wages and/or material costs by region.

Of lesser importance, although still of sufficient significance to be included in the preferred reduced model, are the following drivers:

Increasing the level of deprivation reduces the likelihood of being 'best' for repairs. For example, for a housing association without a DLO in the East region and with median proportion of overheads, the probability of being 'best' as predicted by the preferred reduced model is 33% if the stock is in areas with median levels of deprivation (IMD score of 30); this probability reduces to 27% if the stock were to move to the worst quartile levels of deprivation (IMD score of 41).

Housing associations with a DLO are less likely to be 'best' for repairs than housing associations without a DLO. For example, for a housing association in the East region with the median level of deprivation and median proportion of overheads, the probability of being 'best' as predicted by the preferred reduced model is 33% if the housing association does not have a DLO, and 27% if it does have a DLO.

## Is big really best?

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In the presence of the other characteristic variables, the stock size of a housing association (number of general needs and housing for older people units) was not important in the repairs modelling and was rejected as an explanatory variable early on. In other words, this research could not provide any evidence relating stock size to whether or not a housing association is 'best' on repairs.

There was some weak evidence for a relationship between stock size and whether or not a housing association is 'best' on housing management. However, as other characteristic variables were better at predicting 'best' on housing management, stock size did not make it into the preferred reduced model. Where stock size was included in the early models, the effect on being 'best' did not suggest any economies of scale benefits. Instead, the larger the housing association, the less likely to be 'best' for housing management.

The one characteristic variable which was present in both the final reduced housing management and repairs models was the measure of deprivation. In both cases, the more deprived the areas in which a housing association operates, the less likely to be 'best'.

The proportion of adjusted overall costs which are overheads was particularly significant in predicting whether or not a housing association is 'best' for repairs. The greater this proportion, the greater the likelihood of being 'best' for repairs. This overheads variable did not feature in the final model for housing management.

The region in which a housing association mainly operates and whether or not it has a DLO also featured in the final model for repairs.

<sup>22</sup> The HouseMark ACA reduces costs in Inner London by 21%, in Outer London / London Borders by 11% and in the South East by 5%.

For housing management, it is the association type (traditional or LSVT) and the time since stock transfer for LSVTs which make it into the final model alongside deprivation.

The characteristic variables which were rejected from both the housing management and repairs final models either because others were more important in the regression or there were correlation issues were:

- Ratio of managed housing for older people units to managed general needs/housing for older people units
- Big developer
- Dispersal pockets.



## Appendix two: TSA Paper – understanding unit costs of housing associations – regression analysis

### Outline of regression analysis

Costs of social housing providers are driven by a number of factors. Without controlling for a sufficient range of factors, simple comparisons of costs across groups of providers are unlikely to be meaningful. Regression analysis is a statistical method that overcomes this: it allows one to isolate the effects of a particular factor on costs, *holding all other factors constant*.

In March 2011 the TSA published a full regression analysis to estimate the effect of different cost drivers for housing associations. This was a more extensive exercise than those previously commissioned for the sector, incorporating over 150,000 data points from 2005 to 2010. It drew together data gathered by the TSA (accounts returns, RSR and CORE) and also from national datasets (e.g. regional wages and deprivation). It sought to test the effects of a long list of explanatory factors (over 70 variables) on housing association costs.

**This section outlines the findings of the TSA work which are relevant to this project.**

### The pace of cost inflation

Trends in measured explanatory factors cannot account for the pace of cost inflation in the housing association sector between 2005 and 2010.

### Cost variations

There is a large variation in costs within the housing association sector. The average operating cost (net) per unit over the six years was £3,470.<sup>23</sup> Costs vary considerably and are up to £20,000 per unit for some associations.

There is a clear relationship between *variability* of unexplained costs and size, with variability declining as size increases. There is more variation for the smallest associations in the sample – those with less than 2,000 units under management.

The report says:

*'More variability [of unexplained costs] for the smallest landlords compared to the largest is not surprising, since the largest have greater diversification which allows them to absorb shocks to costs e.g. major repair requirements for a larger landlord with a diverse portfolio of stock is likely to be smoother over time.'*

*'However, it is perhaps surprising that there is still significant variability for medium-sized landlords with around 10,000 units. The distance (negative or positive) between actual and predicted costs for these landlords is around £800, only slightly lower than the level for the smallest landlords in the sample (£1,200). However, average variability is marginal for landlords with at least 20,000 GN units.'*

<sup>23</sup> In 2009 prices.

## Key cost drivers

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Four factors explain 50% of the cost variation:

### **The regional wage effect**

The wage base in London is 37% higher than in the North East (based on administrative and construction wages).

The whole of the differential in regional wages is translated into higher costs: for operating costs on average 110% of any estimated wage differential is reflected in higher costs. The TSA have said that in practice this means that the relationship is approximately 1:1 wages:costs

This means that on average costs for housing associations operating solely in London are 40% higher than for otherwise similar associations operating in the North East

The report notes that the correlation between regional wages and costs may potentially be partly due to higher social housing rents – correlated with regional wages, and not included in the analysis – permitting higher costs.

The report speculates that this might be because:

- The wage index constructed may not adequately reflect the differences in housing association salaries between regions. For example, differences in executive pay between regions may be more marked than for general administrative or construction salaries
- There may be other costs, for example office rental, where cost differences are more marked between regions
- Alternatively, higher social housing rents – correlated with regional wages, and not included in the analysis – may permit higher costs.

### **Supported Housing**

Each unit of Supported Housing is associated with additional operating costs of £8,200 per annum on top of a General Needs unit on average.

The report says:

*‘Given the level of costs involved the amount of specialist housing is critical in understanding the costs of some providers. There is no evidence of economies to specialisation for more specialist SH providers. This may be due to more specialist providers providing more intensive types of social housing or providing wider services.’*

### **Decent homes**

Estimates of the costs associated with achieving Decent Homes Standard is operating costs plus of £8,200 per unit made decent on average, a cost that typically accrues over several years.

### **Deprivation**

Moving from an association with stock in neighbourhoods with median levels of deprivation to one operating in very deprived areas is associated with increased social housing lettings costs of around a third or £1,000/unit per annum on average.

The report says:

*‘Almost certainly deprivation is picking up a range of factors associated with increased costs: more intensive housing management and anti-social behaviour activities, increased letting costs through faster stock turnover, regeneration initiatives and in all probability older stock.’*

## Other cost drivers

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### **Group structures**

Entity-level analysis published in March 2011 found some initial evidence that group subsidiaries had lower unit operating costs than average. It was recognised this may be due to costs incurred by other entities in the group not being captured in the analysis. Subsequent group-level analysis, conducted internally by the TSA on 2009/10 data, seems to confirm this hypothesis – measured on a consolidated basis there was no significant evidence that group structures achieved any lower costs than equivalent stand-alone organisations.

### **LSVTs**

Stock transfer associations have higher costs than otherwise similar traditional housing associations in their early years.

### **Dispersed stock Holdings**

There is some evidence that General Needs stock held in dispersed pockets of 100 or fewer per local authority area are associated with higher social housing lettings costs (up to 50% higher costs).

- Stock in local pockets <100 = costs +50 per cent
- Pockets of >250 = significant effect disappear
- Pockets of <50 = effects even higher
- Sub-regional pockets = effects even higher

## Other issues important to this study

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### **Economies of scale**

The analysis did not generate any strong evidence on economies of scale for General Needs stock, at least in terms of costs at the entity level.

Entity level analysis published in March 2011 has since been updated by group level analysis conducted internally by the TSA and shared with CIH for use in this study. This also found no evidence for economies of scale resulting in lower costs, either through group structures or size of entities.

Moreover, the higher costs of many smaller associations are likely to be due to specialisation in SH.

The report said:

*'The absence of strong evidence on economies of scale for General Needs stock in unit costs data is surprising. One may rationally expect larger organisations to achieve economies of scale in a number of areas such as support functions, procurement, development and through diversification of risks. One theory is that costs across the sector are largely determined by available revenues. Economies of scale may result in higher service levels or quality, or additional services for which the output is not captured by this analysis, rather than lower costs.'*

There appears to be good evidence of returns to scale for shared ownership stock, given a certain degree of specialisation. The scale of non-social stock ownership appears to have no discernible effect on costs.

**There is no clear evidence of any savings from contracting out of management for General Needs stock.**

The report did however say:

*‘The test is not fully conclusive since it may not capture some of the features of a landlord’s contracted-out stock as opposed to retained stock i.e. features that may lead it to be relatively more expensive in the first place. OLS only suggests evidence for savings in one of six years, while the results of the Fixed Effects Model suggest additional costs from contracting out. This may be due to costs associated with the process or circumstances associated with changes in contracting out over time.’*

The full copy of the TSA Paper *Understanding unit costs of housing associations – regression analysis – key points for this research* is available at:

[www.tenantservicesauthority.org/upload/pdf/Understanding\\_Social\\_Housing\\_Costs\\_20110325102844.pdf](http://www.tenantservicesauthority.org/upload/pdf/Understanding_Social_Housing_Costs_20110325102844.pdf)

## Appendix three: Co-regulation at Soha Housing/resident scrutiny

## CO-REGULATION AT Soha

