Strategic Review
The cost and value of Sovereign’s housing products

January 2014
Understanding the present

The cost and value of Sovereign’s housing products

This report brings together the findings of five projects, designed to improve our understanding of how well our housing products perform. The summary table on page 4 uses three perspectives to report on social value: the household; society as a whole; and Sovereign. Currently, all three perspectives are equally weighted.

Key findings by product

- The evaluations on page 4 illustrate how affordable rent performs better for Sovereign, while general needs rent performs better for households and for society.
- The majority of our current stock is **general needs** and it provides a good quality, well maintained, low cost home that minimises the poverty trap effect. It provides Sovereign with long term financial stability, although this stability is undermined by uncertainty around welfare reform.
- **Supported housing** provides a safe and secure community for those with specialist needs and is significantly cheaper than private provision. However, there are challenges of an inflexible, ageing stock profile and the cost of keeping pace with shifting demand and expectation.
- **Affordable rent** on the one hand provides a positive impact on Sovereign in terms of revenue. On the other hand, the extra rent cost is a negative to tenants; even if this extra cost is covered by housing benefit it still deepens benefit dependency and therefore less incentive to work. The risk to Sovereign of welfare reform is magnified and this should be carefully considered when allocating at Affordable Rents.
- **Shared ownership** is a flexible product for us which in most areas provides good income returns. It meets the needs of certain demographics at different life stages, although for some aspiring to own outright it is a compromise, which, when combined with the additional complexities of the product, can lead to lower overall satisfaction.
- Despite being a fraction of our stock, in the wider housing market, **market rent** is becoming more significant. For some it is the only choice and with the standard of service from private landlords and the quality of homes so variable, Sovereign’s market rent offering may appeal to many. However, operating in a market driven environment brings its own challenges and risks.

Key findings for households

- In our model, no housing products are truly affordable for a lone parent in part time work. A couple with no children has the greatest choice.
- For households on low incomes, tax credits and housing benefit smooth out local variations of income and rent. For median income earners, there is financial advantage in living in a high rent/ high pay location.
- **Single people on low earnings** derive significant benefit from the low rents in general needs properties. However, shared ownership is almost equally beneficial if a deposit can be secured. Both options are more affordable, although relatively inflexible, compared to Market rent.
- For **lone parents**, general needs rent provides the lowest hurdle in terms of achieving an aspiration for financial independence.
- **Couples without children** can choose to opt for market-based products, which are affordable even in low-paid work.
- **Couples with children** are under-represented in market rent and shared ownership, both of which are potentially viable choices for two-income households.
Background

The research

Early in 2014, Sovereign undertook a strategic review, helping to set the organisation’s direction. The balance between activities motivated by commercial considerations, and those aimed at achieving social outcomes will be a key consideration within this review.

The work described in this report pulls together the outputs of several projects, aimed at understanding the cost and value of Sovereign’s ‘products’ encompassing both commercial and social value. The projects focused on:

- market prices in our operating areas (James Gibson, Regional Development Director)
- the affordability of our products to residents (Ian Gilders, Welfare Reform Project Director)
- whether our products meet current residents’ needs and support their aspirations (Phil Hardy, Contracts Director)
- the actual costs and income associated with each of our products (Marc Goodey, Director of Financial Services);
- defining the social value of our products (Lisa Denison, Community Investment Director)

The sponsors of each project (in brackets) formed the steering group for the overall evaluation of the cost and value of Sovereign’s products, sponsored by Marc Goodey. The group met to agree the approach to consolidating the work of the five contributory projects into a digestible findings summary.

Our approach

The five contributory projects contain a lot of detailed information. Our aim with this findings paper is to summarise this body of research and pull out the key messages, without reciting too much of the detail. With this in mind, this report does not repeat the methodology used at any length, but references to the appropriate research report as appropriate.

As part of our research into the social value of our products we categorised the cost and value impact of our products into three key areas: the household, wider society, and Sovereign as a business, and this is shown as a summary matrix on page 4. This analysis includes the actual costs and income for each product.

Our work analysing the affordability of our products highlighted that household composition played a vital role in the amount of money a household had to live on after housing costs; their living income. This is explored again in a summary matrix on page 5.

We know that geography plays a key part in both household income and housing costs, and therefore overall living income. Page 6 looks at an example of this in our operating areas and illustrates how geographic variations are smoothed when benefit income is factored in.

Page 7-10 of the report looks at the products we provide in turn, setting out some demographic information about who lives in these properties at Sovereign, how well the product works for different household types, and the risks and opportunities of the product for Sovereign. Supported housing is not included in this analysis as it is not a comparable product; it meets the needs of very specific demographic and the cost and value of supported housing is explored in more detail in the social value research work.
Challenges for this analysis and for future work

Measurement of social value is challenging in any context, and this report aims for a robust but manageable approach that can also be used to evaluate projects. However, a number of issues need to be taken into account in relation to the findings on the following pages.

Financial analysis

The five key products identified in this report represent 88% of Sovereigns income overall, and 97% of income if First Tranche Sales are excluded. Whilst progress has been made in identifying the costs associated with each income stream, this has been challenging, and understanding how we would apportion overheads and other costs to each product is something that is still under review. The rest of the income generated by other products or activities is still significant.

The poverty trap and welfare reform risk

Top up payments of tax credits and benefits have a strong smoothing effect across the lower income range, particularly for households with children. This masks differences in the financial value of different products to households, so it is important to consider the degree to which households rely on housing benefit to secure the ‘living income’ shown in the analysis. For example, a General Needs 2-bed is affordable to a family of four on low earnings, but in Affordable Rent they would be reliant on housing benefit (see table on p.4).

The risks associated with welfare reform are therefore magnified by Affordable Rent in comparison to General Needs (social rent).

Residents’ needs and aspirations

Our ability to evaluate the social value of our housing products to residents is limited by the lack of insight data that could help us to understand their needs and aspirations more clearly. Better data in this area would enable a more robust evaluation, both of our housing products and of specific projects and initiatives.
### Cost and value of Sovereign’s housing products High level matrix

This matrix is derived from the project looking at defining the social value of Sovereign’s housing products. For detail of what we mean by products, please see page 3 of the Social Value research report. For detail on the matrix and how we calculated social value, please see page 4 of the Social Value research report.

<table>
<thead>
<tr>
<th>Value for the household</th>
<th>Value for society</th>
<th>Value for Sovereign</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Wellbeing</strong></td>
<td><strong>Finances</strong></td>
<td><strong>Economy</strong></td>
</tr>
<tr>
<td><strong>General Needs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households benefit from good quality homes and a tailored and caring service</td>
<td>Low, stable rents with security of tenure provide a sound financial base for households</td>
<td>Creation of affordable homes is a benefit to the economy and society</td>
</tr>
<tr>
<td><strong>Supported</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provides a safe, secure, community for those with specialist needs</td>
<td>Low, stable rents with security of tenure</td>
<td>Developing sheltered schemes provides economic stimulus</td>
</tr>
<tr>
<td><strong>Affordable Rent</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households benefit from good quality homes and a tailored and caring service</td>
<td>Rents are below market levels and households enjoy all the other financial benefits of renting socially</td>
<td>Creation of affordable homes is a benefit to the economy and society</td>
</tr>
<tr>
<td><strong>Shared Ownership</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>For some households SO offers a way into home ownership and more freedom than social renting</td>
<td>Cheaper than private rent with the potential for equity growth</td>
<td>Shared ownership brings a wide range of economic benefits</td>
</tr>
<tr>
<td><strong>Market Rent</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Households benefit from good quality flexible solutions</td>
<td>Significantly higher cost than social rents, and often higher than ownership without the equity benefits</td>
<td>A flexible housing solution that takes the strain of economic cycles and provides labour market mobility</td>
</tr>
</tbody>
</table>

### Key

<table>
<thead>
<tr>
<th>Value</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Positive impact on a high scale</td>
</tr>
<tr>
<td>1</td>
<td>Positive impact on a low scale</td>
</tr>
<tr>
<td>0</td>
<td>Neutral impact</td>
</tr>
<tr>
<td>-1</td>
<td>Negative impact on a low scale</td>
</tr>
<tr>
<td>-2</td>
<td>Negative impact on a high scale</td>
</tr>
</tbody>
</table>

This matrix is derived from the project looking at defining the social value of Sovereign’s housing products.
Affordability of housing products, by household

High level matrix

The affordability matrix shows the weekly living income of four typical households by product in Basingstoke and Deane, with the red shading showing the lowest living income with the green shades showing the highest living incomes. For each household, the matrix shows the situation when the household is in low paid work, and when they are on a median income (an average that shows the middle of the range). The living income is calculated as follows:

Net income (Net earnings + income supplements such as tax credits) - Net housing cost (Total housing cost – housing benefit) = Living income

The matrix illustrates the wide range of viable housing options for a couple compared to a single person; and for a couple with children compared to a lone parent. Living income is affected by tax credits and benefits, as well as earnings. So, for example, a lone parent, with only part-time earnings, has the same living income in any rented property. Only couples with at least median incomes are in a position to get a mortgage and own outright, assuming they can provide a 20% deposit. Neither shared nor outright ownership is accessible to the lone parent. A couple with two children in low paid work can afford general needs without reliance on housing benefit, but not affordable rent.

### Households in Basingstoke and Deane

<table>
<thead>
<tr>
<th></th>
<th>Single person, 1 bed</th>
<th>Couple, no children, 1 bed</th>
<th>Lone parent, two children, 2 bed</th>
<th>Couple, two children, 2 bed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Out of work living income</strong></td>
<td>£72</td>
<td>£113</td>
<td>£220</td>
<td>£261</td>
</tr>
<tr>
<td><strong>Household income:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low paid work</td>
<td>£239</td>
<td>£569</td>
<td>£310</td>
<td>£413</td>
</tr>
<tr>
<td>Median</td>
<td>£232</td>
<td>£563</td>
<td>£308</td>
<td>£413</td>
</tr>
<tr>
<td>Low paid work</td>
<td>£310</td>
<td>£308</td>
<td>£80</td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>£308</td>
<td>£63</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low paid work</td>
<td>£413</td>
<td>£658</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>£658</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **General Needs**
- **Affordable Rent**
- **Market Rent**
- **Shared Ownership**
- **Outright Ownership**

*Example: Basingstoke and Deane*
Geographical variations in affordability

Example: A couple with two children in general needs

The two maps highlight the difference in living incomes for those on different incomes. The map on the left shows the living income for a couple with two children in a general needs home on low earnings; the one below shows the same family but on median incomes.

For low earners (left) there is only a marginal difference in living incomes according to geography. This is because of the smoothing effect that tax credits have on living incomes.

For those on median incomes, those living in the more expensive areas tend to have higher living incomes, suggesting the earnings potential outweighs the additional housing costs.

The difference in ranges for the two groups is as follows:

<table>
<thead>
<tr>
<th>Lower earnings living income</th>
<th>Median Income living income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest = Windsor &amp; Maidenhead (£461)</td>
<td>Highest = Wokingham (£768)</td>
</tr>
<tr>
<td>Lowest = Bath &amp; NE Somerset (£400)</td>
<td>Lowest = West Somerset (£396)</td>
</tr>
<tr>
<td>Difference = £61</td>
<td>Difference = £372</td>
</tr>
</tbody>
</table>
GENERAL NEEDS

The majority of our current stock is general needs and it provides a good quality, well maintained, low cost home that minimises the poverty trap affect.

It provides Sovereign with long term financial stability, although this stability is being undermined by the uncertainty around welfare reform.

Value of general needs for Sovereign

There is a consistently high demand for general needs homes because they offer good quality low cost homes for those in need.

General needs provides long term financial stability for Sovereign and investors, allowing us to borrow at low rates. The net present value (NPV) of our general needs stock is largely positive. However, this comes with an opportunity cost in terms of the income we could receive if we had more flexibility in rent setting.

Welfare reform also carries a great risk for Sovereign and this risk is concentrated in the social rent products, because it affects those on benefits. Cuts to housing payments and the imminent change to direct payment threaten what was once a relatively certain income stream. There are also likely to be further restrictions on benefits in the years ahead. General needs presents lower risk than Affordable Rent in this respect, due to lower rent levels.

Value of general needs for different households

It is likely any low earning household will benefit both financially and in terms of wellbeing from being in a general needs property. So the question is which household types benefit the most, or are in greater need (bearing in mind some households can afford more, or aspire to other products)?

General needs is likely to provide most benefit to those households who are disadvantaged, for example those out of work (especially long term unemployed), on low incomes, disabled or with health concerns.

Single people: They have very low living income when out of work, with the risk of this being diminished further by benefit cuts. They do not qualify for benefits on low earnings and so the cheaper rent in general needs properties is important in sustaining low paid employment. Single people with higher incomes may prefer shared ownership or the flexibility of market rent.

Lone parents: 80% are on housing benefit, compared to an average of 56% across Sovereign. Although this suggests they are likely to be out of work our model assumes part-time work on low earnings and they will also be entitled to housing benefit. In day to day terms, lone parents’ living incomes are the same under all rented products because of housing benefit. But in terms of their future, if they were able to move into full time work, general needs is potentially very positive, as it offers greater potential to get off benefits and achieve a higher living income to support their children’s aspirations.

Couples without children: As highlighted in the affordability matrix, couples without children on median incomes could be looking to shared ownership, or even to outright ownership if they can afford the deposit. At Sovereign, like single people, members of this group tend to be older if they are in general needs (80% are over 40), which suggests their children may have moved out. They could be a bedroom tax risk in they are on housing benefit.

Couples with children: This group contribute a large percentage of general needs tenants and this option provides stability for their family, and is particularly helpful for those on low incomes or out of work. However, our model suggests that outright ownership may be a realistic option for median income households, and shared ownership for low earning households, if a deposit can be secured.

Who are our general needs households?

Households in general needs are more likely to have children than all other products, except Affordable Rent. They are also more likely to have more than two adults (including adult children) reflecting that they are likely to be long-standing tenancies and therefore more frequently house households at various life stages. This means the average age of the lead tenant is higher than other products (except supported).

44% of general needs households do not claim housing benefit, higher than those in supported or affordable rent, but lower than those in market products. According to CACI data, half of general needs households are in work and over 60% have a household income under £30,000.

Newer general needs tenants are younger, slightly more likely to be in work but also more likely to be claiming housing benefit.

81% of Berkshire tenancies are general needs, compared with just 68% in Devon.

The most common property size is 3 bed (41%), whereas it is 2 bed for each other product, reflecting the traditional target market of families with children in general needs.

80% of general needs households are satisfied with the services we offer, lower than Supported (88%) but significantly higher than shared ownership (54%).
Affordable rent was introduced in Sovereign in 2012, so is still a relatively new product, accounting for 521 of our properties. This is likely to increase significantly moving forward under the affordable rent model.

Given how new the product is, it is not surprising that it is dominated by younger families compared to general needs, which has more long-standing tenancies. They are more likely to have children (64%) compared to general needs (39%). 71% of lead tenants are under 40 compared to just 33% in general needs.

With the exception of supported housing, households in affordable rent are least likely to be employed and most likely to be claiming housing benefit. Their income levels are similar to those in general needs, with 62% on household incomes less than £30,000.

Affordable rent is basically the same product offering as general needs, so offers all of the same wellbeing benefits to households of a good quality home and tailored service. The difference is financial; there is almost a £50 a week difference in general needs and affordable rents on average where we operate.

Single people: Those out of work receive just £72 a week to live on so are vulnerable to cuts to their benefits, or reductions in real terms. Those on lower earnings or median income will not receive housing benefit so will have to pay the difference in rent levels. The household will be better off than in market rent, but worse off than general needs.

Lone parents: As with general needs, in day to day terms, all rented options are the same because they are reliant on benefits; but being on higher rents than general needs makes increasing their living income that much harder, as they have further to go before they come off benefits. As this last point is more aspirational than tangible. It is perhaps not surprising that lone parents are the most common household type in our affordable rent properties, making up nearly a third; however, the higher rents will make it harder to fulfil an aspiration to financial independence.

Couples without children: This group accounts for 10% of our current affordable rent stock; because of their higher earnings potential market products could be a viable alternative. Looking at the affordability matrix it is difficult to see a reason why this group should be prioritised for affordable rent or social rent, and they may benefit from the flexibility of market rent. However, those out of work would be more able to move into work and achieve independence in lower rent general needs properties.

Couples with children: This is the second most common household type in our affordable rent, at 29%. Unlike lone parents, there is in most areas a direct financial cost to couples with children on low earnings or median incomes being in affordable rent rather than general needs. As with couples without children, unless they are out of work, market rent could be a viable option for this group if they are not able to, or not aiming to, get into home ownership.
Shared ownership meets a specific need for those who aspire to home ownership but cannot afford to buy on the open market. It gives a household the security of having their own home and stability to plan for the future. However, it may not fully deliver on the purchaser’s aspirations linked to home ownership, as reflected in satisfaction levels.

Shared ownership can provide a solution to someone who has limited options: it is popular with certain demographics as a solution to specific life situations e.g. family break up. Shared ownership is only an option (at time of purchase) for a household in employment and with enough money for a deposit, although weekly costs are comparable to affordable rent and cheaper than market rent.

**Single people:** Those on low earnings or median incomes who can afford a deposit will have a similar living income to those in general needs, in weekly terms. However, this is for a one bed which accounts for only 11% of our shared ownership properties; the extra cost of a 2 bed may price some out. They are the most common household type of our shared owners (43%). There is a wide range of single people in shared ownership, slightly skewed towards younger people, indicating shared ownership meets a broad range of needs.

**Lone parents:** The evidence from our affordability work suggests shared ownership is not a feasible option for the majority of lone parents. This is confirmed by the fact that only 2% of our shared owners are lone parents.

**Couples without children:** As highlighted in the affordability matrix, couples without children on higher incomes could be looking to shared ownership, or to outright ownership if they can afford the deposit. 32% of our shared owners are couples without children. They tend to be slightly younger than single shared owners, although 40% are over 40, which again indicates it meets a broad range of needs.

**Couples with children:** Despite couples with children being more able to afford shared ownership than single parents, the numbers suggest not many find their way to this product, comprising only 8% of our shared owners. The vast majority of these are in their 30s and 40s, suggesting these households may aspire to, but be priced out of outright ownership. For couples with children on median incomes, shared ownership is financially preferable to market rent in day to day terms.
MARKET RENT

People in market rented homes through Sovereign are likely to benefit from a higher quality product and a more professional service from their landlord than they might get privately. The flexibility it provides does suit certain households. However, this might be the only option for others, who face higher costs, less rent certainty, less security of tenure and less service compared to general needs.

Single people: Market rent is the least favourable option for this group financially. Those on low earnings or median incomes will not receive housing benefit so market rent will be a more expensive option. Some may be happy to pay the extra for the flexibility market rent provides, or may prefer market rent due to the range of properties.

Lone parents: Those in work and on benefits will have the same living income in market rent properties as they would in general needs, so there is no immediate financial difference. In terms of their future, if they were able to move into full time work, the gap between what they need to earn to get off benefits and achieve a higher living income to support their children’s aspirations will be higher under market rent than general needs.

Couples without children: This group (when in work) are likely to be able to afford the extra cost of market rent, and are viewed as a typical customer of this product. They may use market rent for a variety of reasons; while they save for ownership; for flexibility; to avoid the risks of ownership, or simply that it is their only choice if they are priced out of ownership and are not eligible for social rent — the so called ‘squeezed middle’.

Couples with children: This is not a group that typically uses market rent at Sovereign—just 2% of tenancies since May 2012 are couples with children. The data from the affordability matrix suggests this is an affordable option; general needs is cheaper but some may be happy to pay extra for the greater flexibility it provides and increased choice of where to live. This is potentially an untapped market for market rent.