



Strategic Review
Scenario planning

January 2014

Scenario planning

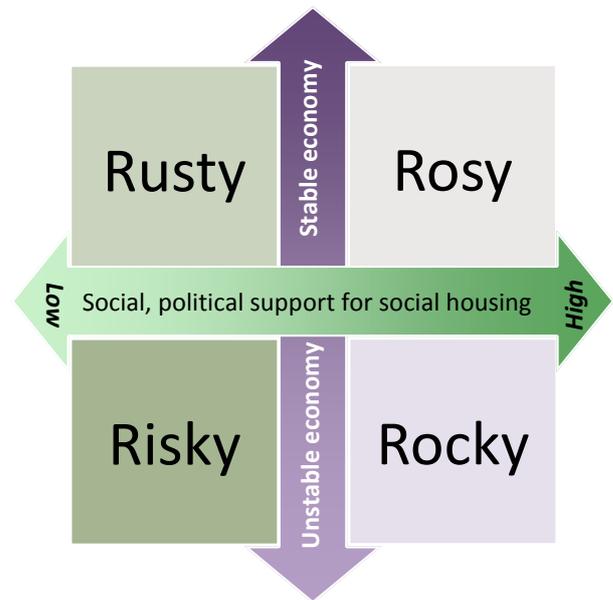


In 2014, we undertook a strategic review to set Sovereign’s direction for the next three years. The review looked at how we can continue to balance commercial and social considerations.

As part of our preparation, we carried out research into different aspects of our work and our current operating environment.

The next stage involved thinking about the future operating environment, and how we might respond to it. To ensure our decisions today could respond to an uncertain future, we created possible scenarios to test our plans.

The following report explains the process using scenarios, as well as detailed descriptions of the different operating environments we may face.



Summary

Rosy	<p>The UK has a stable economy and political direction. This relatively comfortable position has allowed a resurgence of social consciousness at a public and political level.</p> <p>Care for the disadvantaged is recognised as necessary, and social housing is seen as having a role in supporting the aspirations of working people, and those looking for work. Government and regulation is light-handed. Coalition government has been a success.</p>
Rocky	<p>Boom and bust have continued to affect the UK economy, as governments with slim majorities have veered between different approaches. For all governments, reducing public spending has remained a priority.</p> <p>Social support policies have remained popular, but political priorities are health and education, and investment programmes in other areas are patchy.</p>
Rusty	<p>Growth is steady in a stable economy, but society has become increasingly individualistic, and there is little support for socially-motivated interventions, including social housing.</p> <p>The informal economy is growing, and mushrooming informal settlements contrast with gated communities. Economic growth has been focused in the south east, and the regional divide reflects the divisions between the countries of the UK.</p>
Risky	<p>Long term financial and political instability has reduced benefit spend to the bare minimum and undermined any sentiment in support of a social welfare agenda.</p> <p>Public services are weak and poorly managed, following years of under investment and poor morale and social housing is now a last resort for those assessed as most in need or deserving</p>

What are scenarios?

Scenarios are not forecasts. They are a way of thinking about the future.

Forecasts claim to predict that a specific thing will happen by a definite date. For example “50% of the population in France will be retired by 2020”. Forecasts are often wrong, because the world is changing all the time; what seems like a good prediction today may look weak and shaky tomorrow.

Scenarios are a way of thinking about the future that takes the uncertainty into account. Each scenario is “an internally consistent view of what the future might be; not a forecast but one possible future outcome” (Michael Porter). So each of the scenarios needs to ‘hang together’, and make sense.

We have developed four possible future scenarios for Sovereign. We are not expecting any of the four scenarios to ‘come true’; but it seems likely that the future may include elements from each of the scenarios.

How have we developed our scenarios?

Step 1: We started by interviewing a range of people from across social housing, to find out what they thought were the big issues likely to affect housing associations in 2025.

The interviews included senior representatives from the Housing and Communities Agency, National Housing Federation and Chartered Institute of Housing, as well as our own Executive Board.

We used their views to identify a list of factors that will shape our future.

Step 2: Next, we held a workshop with Sovereign’s Senior Leadership Group (SLG), to decide which of these factors were the most important. The workshop settled on:

Economic stability and social and political support for social housing as the key factors.

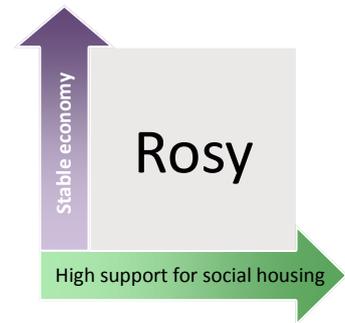
Step 3: We used these key factors to help us shape four possible scenarios, based on:

- Stable economy and high political and social support for social housing
- Unstable economy but high political and social support for social housing
- Stable economy but low political and social support for social housing
- Unstable economy and low political and social support for social housing

Each scenario describes what the world could be like in 2025. For example, would there be grant funding for new homes? Would there still be housing benefit? How would people get access to social housing?

The UK has a stable economy and political direction. This relatively comfortable position has allowed a resurgence of social consciousness at a public and political level.

Care for the disadvantaged is recognised as necessary, and social housing is seen as having a role in supporting the aspirations of working people, and those looking for work. Government and regulation is light-handed. Coalition government has been a success.



Economic and Political Framework

The UK and the rest of the western world largely solved the issues following the 2008-2009 recession with a period of relative austerity that lasted nearly 10 years, accompanied by steady improvement in global GDP growth rate, substantially supported by China and India.

Most western government budgets are generally in a satisfactory position, with reduced debt, although there are still some significant exceptions, most within the EU. The EU however has come through stronger economically and politically.

China and India are achieving steady high growth albeit with occasional disruptions. World trade is strong, and relationships generally amicable. Western GDP growth rates are now at sustainable historical levels

Developments in the UK

In the UK this comfortable position has been achieved by a series of well-structured coalition governments which have prevented large swings in spending or policy.

Public expenditure has taken the brunt of reducing the budget deficit, but this position is now being relaxed, subject to strict value for money constraints. Regulation and legislation are light partly because of the challenges within a coalition but also as a direct policy to allow markets to work in a steady economic environment. Regulation is aimed at seeking the best market solutions,

GDP growth is around its historical norm. Unemployment is low. Employment growth is

strong in services but with a growing high tech manufacturing base, including new environmental products and services.

Public sector spending is directed at infrastructure improvements and the creation of jobs for all who can work. The construction sector is strong, with house-building based on non-traditional construction playing a major part. Traditional construction skills remain in strong demand for repairing and improving the still-ageing housing stock.

Technology continues its impact on lifestyle, at home and at work, and has moved on from largely digital based improvements to new materials and intelligent hardware, and new manufacturing methods. The digitalisation of the economy is extensive, with easy access for all, and continual efforts are made by government to ensure that there is minimal digital exclusion, and thus minimisation of the cost of government.

The ageing population is healthy and wealthy although there is strong growth in demand for health services from the NHS. Immigration remains relatively high as East Europeans and others take advantage of the UK's strong economy. European migrants increasingly settle and integrate, in contrast to earlier, transient workers.

Housing provision

Higher levels of house-building have been accepted as necessary to solve the housing shortage, to prevent further house price bubbles, and to provide employment.

The quality of new homes has improved largely due to off-site construction processes, which were developed in response to the skills shortages of 2008 – 2020, and to environmental concerns relating to traditional materials. Partly as a result of this, resistance to new building has lessened.

Within a stable housing market, demand for owner occupation remains strong. Mortgage funding is widely available, but lenders take a cautious approach and the stability of house prices minimises take up of poor value mortgage products. Developers have adjusted their business model to deliver a steady supply of new homes across the market.

Social housing is recognised as playing an important role, with capital subsidy available to secure added value in regeneration or specialist provision, and low cost government loans for the development of general needs rented homes. Private funding remains available at low rates, for HAs able to demonstrate a strong business. Funders take comfort from the secondary funding provided by Government.

Government-funded Green Investment programmes, developed during the 20-teens, have helped to improve the environmental performance of social housing, and active asset management has reduced the proportion of poor quality social sector homes, although there is more to do.

Housing Associations offer creative, high quality housing solutions, designed (and priced) to help residents take advantage of the economic opportunities offered by high employment and steady growth. Newbuild homes are very similar in appearance to those offered on the mid-priced open market, and there has been a levelling of standards, as the focus has shifted to quality, rather than quick delivery in an overheated market.

Residents expect high standards, and a HA tenancy is starting to be seen as a desirable option, particularly for busy families who will

have the option to buy their home with add-on packages such as maintenance, energy, or communication services. The high quality and social value of HA services is increasingly important in recruiting and retaining skilled staff. In an era of high employment and strong opportunities, HAs struggle to match private sector salaries.

Private renting has a part to play, particularly for the young and geographically mobile. Consumer regulation of lettings agents, by the Housing Ombudsman, coupled with increased stability in the housing market, has improved the consumer power of private renters. The quality of accommodation and services is improving.

The HCA has developed its skills base in relation to regulating governance and viability, and has made judicious use of the increased intervention powers granted during the austerity years. No HA has defaulted on its loans, although a number of small and medium HAs have been rescued by larger ones in forced mergers, and one large, well known HA was broken up. Consumer regulation is now provided by the Housing Ombudsman, using consistent standards across all rented homes.

Public services and welfare

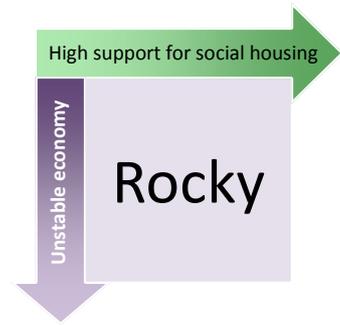
The merits of a broad approach to community-based services were recognised by HAs during the period of austerity and recovery.

They are now seen as very positive partners for LAs, and relationships are generally harmonious. Public services are recovering quickly

Support for rental payments through Universal Credit (formerly Housing Benefit) remains constrained. HAs and LAs work together to deliver constructive solutions for individuals, and LAs have retained a role as mediators between HAs and DWP.

Boom and bust have continued to affect the UK economy, as governments with slim majorities have veered between different approaches. For all governments, reducing public spending has remained a priority.

Social support policies have remained popular, but political priorities are health and education, and investment programmes in other areas are patchy.



Economic and Political Framework

The UK and the rest of the western world have not really sorted out the issues following the 2008-2009 recession. There has been insufficient political will to maintain austerity packages where they are needed and western economies have cycled between short periods of high and very low growth. Global GDP growth has only been held at relatively high levels by developing and emerging economies.

The EU has not succeeded in correcting the imbalances in its economy, and the economically weakest nations are still suffering. East European economies have improved by dint of application and the growth of trade within the EU. In spite of some difficulties the EU and the Euro have held together.

Developments in the UK

Coalition government in the UK has not been a success, and there has been a shift to the left, with several curtailed terms of office of right wing/coalition governments. The leading minority parties have been largely socially concerned, which has meant that the overall balance of government has been to pursue socially responsible policies where it can afford them. But these tend to get turned on and off with changes in government.

There has been accompanying constant change in economic policy that has damaged the country. The period of austerity following the recession has been alternately relaxed and tightened so the government's finances have

not improved and economic growth has been lower than historical levels. The City has slipped in its ranking in the world, interest rates and inflation are above norm and finance is not easy to come by except for "safe investment", which remains attractive to funders.

Continued changes in policy have stretched the public sector and, with limited funding, the civil service has become less effective, lacking the innovation needed to deliver political priorities.

Unemployment levels are again at the level of 2013. UK manufacturers have not been able to compete with Eastern Europe and the Far East. The service sector is the strongest part of the economy.

Technology continues to change lifestyles. A substantial proportion of the hardware is coming from abroad, but the UK is maintaining its position in entertainment and education software. Access to technology is widespread but there are pockets of exclusion, geographically and socially.

The ageing population is suffering from degradation of its savings, and pressure on the NHS, which is still regarded as a social right by government but is suffering from restricted funding.

Housing provision

Construction is very cyclical, with housing developers responding quickly to boom/bust cycles. There is a reasonable level of house building, but standards are often low, as the sector has not invested in skills or innovation.

Housing is seen as a source of asset investment that can be paid for by the private sector. Land banking and speculation is widespread, and there has been no effective policy response.

The aspiration for owner occupation is strong, and volatile house prices have contributed to a return to high risk mortgages. Housing Associations have become key players in the low cost home ownership market, competing strongly against developer-sponsored first time buyer 'deals'.

Housing Associations have had mixed success in this challenging environment. Grant funding has been available intermittently, and has generally been targeted on value-adding regeneration or extra care provision. Some larger HAs have had the financial strength to invest in land, and have secured private funding to deliver a mixed programme, including high quality social housing. These HAs have been highly critical of the targeting of government grant, which they believe has subsidised inefficiency, and the high environmental standards required for grant-funded social housing.

With HAs struggling to keep up with housing need, the quality of new homes reflects standards at the bottom of the market. HAs continue to focus on delivering value-adding social support services, especially for older residents, but the standard of core housing management and maintenance services has slipped. Although long-established residents vocally regret the reduction in standards, newer residents are more concerned about access to housing.

The private rented market has flexed to respond to the gaps created by variable access to owner-occupation. Institutional investment has not really developed, and the sector is dominated by very small scale providers, working with managing agents of variable quality. Consumer power is weak. Regulation is regularly discussed but has not yet been delivered.

Regulation of housing associations is ineffective and behind the curve, as the regulator has focused on fire fighting, and has not developed necessary skills. Mergers have been driven largely by the retirement of incumbent CEOs. None have been prevented by the regulator, but some have been financially disastrous. In fact, financial crises have become increasingly common for over-extended medium HAs. In several cases, funders have worked with the HCA to broker 'rescue' packages in which they have repossessed tenanted homes, which have been managed by another HA, and sold when empty to repay defaulted debt.

Public services and welfare

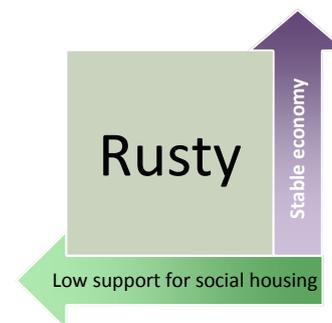
HAs' social mission has become a key element in their ability to attract employees. Staff turnover is low, and this creates challenges in delivering the necessary mix of commercial and other skills.

Community-based pressure groups and support groups are an increasingly important element in the overall picture of services to the public. Housing Associations' relationships with LAs remain strong, but LA services are patchy, depending on local strengths. Remaining services focus on the needs of the ageing population. Leisure and cultural services are very limited.

Support for rental payments through Universal Credit (formerly Housing Benefit) remains constrained. LAs have retained a role as mediators between HAs and DWP, but this is locally-driven, and quality is variable. LAs' approach to nominations and lettings is inconsistent, adding complexity (and cost) for large HAs.

Growth is steady in a stable economy, but society has become increasingly individualistic, and there is little support for socially-motivated interventions, including social housing.

The informal economy is growing, and mushrooming informal settlements contrast with gated communities. Economic growth has been focused in the south east, and the regional divide reflects the divisions between the countries of the UK.



Economic and Political Framework

Coming out of the 2008-2009 recession has been slow but steady in the western world and the austerity measures imposed by most of the western nations have held up with satisfactory results.

Recognition of this success has meant that many western nations have retained tight social policies. Political attitudes are becoming more nationalistic and independence is important.

Developments in the UK

A strengthening of alternative right wing minority parties in UK politics has led to a shift to the right, either through the need to win votes or through coalition.

There has been a consistent view of how the economy should be managed, largely via market forces, which has achieved medium but steady growth. Action is taken on any signs of overheating with some success. Government debt is very well under control.

Although the UK is still in the EU, the relationship is tenuous, reflecting a global attitude of nationalism and independence. The UK feels that its independent policies of austerity were less painful than the costs imposed on Germany supporting the Euro throughout the recovery. UK has stayed out of the Euro resulting in a weakening relationship with a battered but elated EU. Scotland has become independent. Wales wants to follow. Northern Ireland remains strongly unionist.

Recorded unemployment is low but this conceals low wages, part time working and insecure employment for some. Business is

doing well in a stable economy, innovation and investment in technology is high with good rewards for the successful. Most people in the UK have access to IT and the internet, but speed and quality reflect complex pricing structures. The UK has secured a lead in several green technologies

Social Security benefits are tightly controlled, and are increasingly recoverable when people return to work. Charity is encouraged to fill gaps in social security but the hoped-for emergence of voluntary provision has not materialised. A national basic safety net is maintained for older people, children and the disabled. For people of working age, the emphasis is on "Helping those who want to help themselves". A social divide is developing between those in good jobs and those without, exacerbated by a steady reduction in non means-tested benefits. The informal economy appears to be increasingly important, with widespread cash and 'in kind' transactions alongside an increasingly cashless mainstream economy.

GDP growth rates are strong, manufacturing is showing some recovery in technical fields but services are also strong. Growth is concentrated in the south east, although some other regions have seen growth in small scale or specialist manufacturing, bolstered by work force flexibility and the ready availability of premises.

Those in the ageing population with satisfactory pensions and savings are enjoying good retirements, and private health services are popular, although this provides little respite for a cash stretched NHS. The protection of public funding for services and

RUSTY: Stable economy but low political and social support for social housing

benefits to older people has reduced, and most benefits are frozen or means-tested. Immigration levels have dropped as the UK tries to constrain benefits paid to immigrants and the migrants' home countries' economies improve.

Housing provision

Construction is strong with a focus on private housing although the shortage of housing land has maintained house price inflation at high levels. There have been modest improvements in build quality, and some innovation in materials.

Demand for owner occupation remains high, as it is still seen as a strong investment. Mortgage availability is good for those in stable employment, but there is also a market in high-cost sub-prime mortgages, as lenders take comfort in the increasing value of the mortgaged property.

Housing Associations have struggled to provide new homes since the end of grant funding for general needs housing in the 20-teens. 'Soft' government loans are available for homes occupied by local authority nominees, and this helps to secure a stream of private funding. All tenancies are temporary, and are subject to regular means-testing at levels set by LAs. Some maverick HAs are also able to provide a supply of traditional social housing, through cross-subsidy from commercial development, and a trickle of receipts on low cost home ownership, and Right to Buy (which has been extended to all social tenants). The stable land and housing market enables a slow but steady supply, reducing the speed of overall decline in stock.

Standards for both newbuild and existing social housing have reduced, and services are decreasing in quality. Few HAs are able to support direct provision of value-adding services, so the 'last resort' nature of social housing is immediately apparent. HA tenants compare their homes to the alternatives, and have realistically low expectations.

There is strong demand for private rented

accommodation, with two distinct markets emerging. Institutional investment supports the delivery of flexible, high value rented accommodation for a mobile workforce, including hostels for young people relocating from economically depressed regions. However, there are also small scale providers, including informal employers, providing generally poor quality shared and temporary accommodation. Formal or collective consumer power is weak: "you pay your money and you take your choice". Regulation of these private arrangements is not a priority.

Regulation is focused on protecting government expenditure, and ensuring that limited resources are focused on those that are both 'needy' and 'deserving'. Only the most financially robust HAs are able to develop new homes. Others have adopted a risk-averse approach, and are in managed decline as stocks dwindle. The regulator has expressed concern at the prospect of some HAs' asset bases becoming uneconomic, but rising property values offer some protection.

Public services and welfare

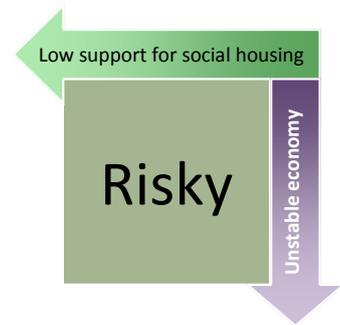
There is a constant tension between LAs' desire to respond to political priorities (focusing support on 'strivers', and optimising the contribution of 'fat cat' HAs), and HAs' desire to achieve stable communities (with lower management costs, and more stable income streams). Neither side in this debate is sufficiently well-resourced to develop creative solutions, and the tension leads to relationships often becoming strained.

Leisure and cultural services have gradually increased in cost. Where these are still provided by LAs, they are regarded as a cash cow, and are priced at levels often inaccessible to HA tenants.

The housing element of Universal Credit is now fixed at a regional level, which does not necessarily reflect rents. LAs have no influence over this process, and are struggling to deal with the exodus from high value areas (such as London).

Long term financial and political instability has reduced benefit spend to the bare minimum and undermined any sentiment in support of a social welfare agenda.

Public services are weak and poorly managed, following years of under investment and poor morale and social housing is now a last resort for those assessed as most in need or deserving.



Economic and Political Framework

Following the 2008/9 recession a series of economic setbacks caused the Euro to finally collapse leading to another deep European recession from which the weaker members of Europe never recovered; the USA became more insular with the success of its energy policy based on shale oil and gas, and found trading with the Far East more attractive than with Europe; the UK's anticipated upturn has only just started after ten lost years.

The UK's relationship with Europe is weak and the collapse of the euro has hindered trade agreements. Barriers to labour mobility and other economic constraints are increasing.

Developments in the UK

UK trade and inward investment have been very weak and economic growth rates have oscillated around zero. Dissatisfaction at all levels has caused successive government changes. Continual policy change has made it difficult for business to plan and invest.

Over ten years of unstable government and economy have exhausted most options for the implementation of any significant social policy and benefits and support for the disadvantaged have been pared to the bone.

Commodity prices have been forced up by strong growth in India and China and inflation in the UK has been above trend most of the period, so those with assets have pulled ahead opening the divide between rich and poor. Unemployment is high and many of those in work are on low wages and in unstable employment. Only in a few sectors does labour have the power to ensure high wages.

The UK's lead in finance and the City's place in the world is threatened by financial centres in the Far East and a strengthening dollar. Manufacturing for local markets has been a growth sector, services to the private sector have remained strong but the public sector has reduced. The media sector has survived due to historical strength. Other technology sectors have not blossomed due to lack of local market. For those employed, technology is readily available but there is a growing group of digitally excluded, particularly in the countryside and amongst the unemployed and low paid.

Action on environmental issues within the UK is on hold due to lack of resources. Besides, high energy prices are forcing energy conservation. There is little investment in innovation on environmental matters nor on productivity labour improvements as labour is relatively cheap and investment funds hard to find. However there is a growing market for low tech retrofit energy conservation on buildings as energy costs rise. Apart from this the construction sector is very weak.

The retired population is suffering from poor investment returns; the withdrawal of all but safety-net benefits; and a poor service from an impoverished NHS. Migration levels are variable depending on the relative economic position of the UK and migrants home countries, many migrants envisaging only temporary stays in the UK.

Housing provision

Developers have large land banks, and are able to deliver new homes quickly during upturns. Quality is variable, but demand is

always strong, and first time buyer incentives are popular.

The private rented market is able to absorb any surplus output, with both institutional (including HAs) and individual investors.

Access to owner occupation is very difficult, particularly for those without high deposits. The unstable housing market means mortgage lenders have remained cautious, and few people now have the stable long term employment required.

Some HAs compete well in the Low Cost Home Ownership market, but without subsidy they depend on their social brand, and service quality. Social Housing is firmly positioned as a stop gap, and is largely separate from state intervention, as there is no mainstream funding. All HA surpluses are taxed (including receipts from the expanded Right to Buy), with the exception of a small number of charitable HAs, notably those providing exclusively for older or disabled people.

The HA sector has divided. Some HAs have recognised the commercial imperative of maintaining income streams, and provide basic homes at low market rents, often in partnership with employers. Others have drawn on their charitable roots to attract philanthropic investment, and focus on the 'neediness' of their residents.

Generally, standards for both newbuild and existing social housing have reduced, and services are decreasing in quality. Few HAs are able to support direct provision of value-adding services, so the 'last resort' nature of social housing is immediately apparent. HA tenants compare their homes to the alternatives, and have realistically low expectations.

A new group of housing providers is starting to emerge, sometimes working in partnership with HAs. These groups cater for the least well off, and 'repurpose' redundant buildings to provide temporary accommodation at relatively low cost, with only very basic service provision.

Private renting has expanded significantly, encompassing employer-sponsored and fully independent provision. Standards across the sector are variable, with access to higher quality accommodation driven by the ability to pay large up-front charges, or the possession of in-demand skills. Demand is high across the market, particularly from the flexible workforce, but consumer power is weak. Regulation of these private arrangements is not a priority.

Regulation is focused on protecting government expenditure, and ensuring that limited resources are focused on those that are both 'needy' and 'deserving'. Only the most financially robust HAs are able to develop new homes. Others have adopted a risk-averse approach, and are in managed decline as stocks dwindle. The regulator has expressed concern at the prospect of some HAs' asset bases becoming uneconomic, but rising property values offer some protection.

Public services and welfare

In some locations, there is a residual relationship between HAs and LAs, governing access to temporary family housing. In this, as in other areas, LAs are poor partners; managing a declining service base through an increasingly low skilled workforce. HAs retain a social mission, but the challenges of delivering either new homes or high quality services lead to widespread disillusion and frustration within the sector.

No non-statutory services are provided by LAs. There has been some development of paid and charitably sponsored public leisure and cultural services, but funding is insecure.

Universal Credit is now contribution-linked, with a 'vouchers-only' alternative for those with no contributions (so long as they have a fixed address). The housing element of Universal Credit is fixed at a regional level, which does not necessarily reflect costs. LAs have no influence over this process, and are struggling to deal with the exodus from high value areas (such as London).



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