UK Budget

# Summer Budget: rent cut pushes social landlords towards financial crisis


Plans to allow more social housing tenants the "right to buy" for will further stymie construction

JULY 10, 2015 by: Kate Allen

George Osborne's Summer Budget cut to social housing rents is set to throw the organisations that own half of Britain's tenanted homes into their biggest financial crisis and could lead to a court challenge.

Social landlords own half of Britain's rented homes and build one in five of all new homes constructed.

Mr Osborne on Wednesday imposed a reduction of 1 per cent a year for the next four years on rents from councils and housing associations — which are not-for-profit private companies and charities.

The Institute for Fiscal Studies estimates that the cut will reduce landlords' income from rents by £2.5bn a year; 1.2m households will save on average £700 a year, it said.

The announcement caught the sector by surprise. Just last year the government had committed to rent increases based on the CPI measure of inflation for the next decade.

Devonshires, the leading social housing law firm, warned its clients in a briefing on Wednesday evening that the consequences of the cut were "potentially very serious". Because of the previous 10-year promise, Devonshires said Mr Osborne's decision was "significantly susceptible to a judicial review application".

Several senior social housing sources told the Financial Times that some landlords would go bust as a result of the cut.

It means that by 2020-21, landlords' rents will be 12 per cent lower than previously forecast, according to Treasury estimates. The Office for Budget Responsibility said the drop in rental income was likely to result in housing associations calling off plans to build 14,000 homes; the National Housing Federation said this figure was nearer to 27,000.

In addition to hitting housebuilding volumes, the cut is likely to reduce the value of landlords' properties, and could result in breaches of loan covenants and even auditors refusing to sign off accounts on a "going concern" basis, Devonshires warned.

Robert Grundy, head of housing at property advisers Savills, said the value of landlords' homes — based on the most common methodology used by auditors — would fall 25 to 30 per cent immediately, and by as much as 40 per cent over four years. Valuations for lending purposes would not be quite so badly hit, he added.

"This is the biggest thing to hit the sector for 20 years," he said, citing only two past events of "similar magnitude": the introduction of Right To Buy in the early 1980s and the creation of stock transfer — which saw housing associations take over more than 1m council-owned homes — in the early 1990s.

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One longstanding housing association chief executive said the cut was "by far and away the biggest [business] threat I've faced" in more than three decades.

"Undoubtedly some organisations will run out of cash, and not just small associations either — some big landlords will come unstuck," he said. "It was only last year they said our rents would rise based on CPI for 10 years, and we've all gone out and borrowed billions of pounds based on that."

British social landlords have borrowed more than £60bn of private finance over the past three decades.

Many social landlords are worried that the cut will deter lenders from making further finance commitments.

Andrew Cowan, senior partner at Devonshires, said he was concerned that lenders might be tempted to try to pull unsigned financing deals or restrict landlords' access to previously arranged borrowings, which could cause liquidity problems for affected landlords.

Moody's credit rating agency warned on Thursday that the cut was "credit negative" because it would "reduce housing associations' revenue streams and suppress operating margins".

Roshana Arasaratnam, vice-president of Moody's public sector Europe, said it meant "less predictability in social housing policy, leading to a more challenging operating environment".

The OBR warned on Wednesday that government interference in housing associations' businesses — including the forthcoming extension of Right To Buy, and the new rent cuts — risked reclassifying the private organisations as public sector bodies.

This would bring their £60bn of borrowings on to the public sector balance sheet.

A Department for Communities and Local Government spokesman said social landlords received £13bn a year in housing benefit and rent increases in the sector had on average been more than double those of private landlords over the past five years.

"Reducing social rents will help protect social tenants from rising housing costs whilst protecting taxpayers from the rising costs of subsidising rents," he said. "Housing associations have proved themselves to be more than capable to adapt and respond to change, and we are confident that they will be able to find and make efficiencies to accommodate this new settlement."

The government will reinstate the previous inflation-linked annual rent increases in four years' time, he added.

*This article has been amended in relation to Mr Cowan's comments*