Ministry of Housing, Communities & Local Government

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Clive Betts MP
Chair, HCLG Select Committee
House of Commons
London
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By email

20th May 2019

Dear Clive,

VALUE FOR MONEY CASE FOR THE VOLUNTARY RIGHT TO BUY

In my letter of 15 February, I promised to write with an explanation of the elements of the Value for Money (VFM) analysis for the Voluntary Right to Buy.

I attach a short note from the Department, which I hope the Committee will find helpful.

Yours,

Melanie Dawes

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VALUE FOR MONEY CASE FOR THE VOLUNTARY RIGHT TO BUY

1. Overview

1.1. In 2015, the Government announced its intention to extend the Right to Buy to housing association tenants. A voluntary agreement was made with the National Housing Federation (NHF), under which the policy would be delivered by housing associations on a voluntary basis, and not through legislation. The voluntary agreement was based on four key principles:

i. Housing association tenants would be offered the same level of discount as council tenants;
ii. The Government would fully compensate housing associations for the cost of the discount, meaning that associations would receive full market value for the properties sold;
iii. Housing associations would have discretion over which homes to sell, and where properties were excluded, would give tenants the opportunity to port their discount to another housing association property; and
iv. Housing associations would deliver an additional home through new supply nationally for every home sold.

1.2 A small-scale pilot with five housing associations was carried out to inform the design of the scheme, which concluded in 2017.

1.3. A second, more extensive pilot of the Voluntary Right to Buy (VRtB) was announced in the Autumn Budget of 2017 [1], to take place in the Midlands. This pilot was launched in August 2018 and will conclude in 2020, and will test the operability of the policy on a larger scale and key parts of the voluntary agreement not tested in the initial pilot. This includes portable discounts for tenants who cannot buy the home they are in and one-for-one replacement of the homes sold.

1.4. It will also test how the policy operates in practice across large and smaller associations, developing and non-developing ones, and across urban and rural areas. Learning about these will be captured through an evaluation, which will be published in Autumn 2020 after the pilot concludes.

1.5. The Voluntary Right to Buy was introduced because discounted home ownership options are not available to the majority of housing association tenants. Making available Right to Buy level discounts to more housing association tenants through the Voluntary Right to Buy will enable more social tenants to access this route to home ownership.

2. The economic case for the VRtB

2.1 The main elements of the economic case for the VRtB are as follows:

- A **cash transfer** between the Exchequer and individual housing associations;
- Benefits **to the tenant** that is purchasing their home as a result of receiving the VRtB discount;
- The economic value of **homes built to replace those sold** under the VRtB;
- **Other economic benefits** associated with the replacement homes, e.g. health benefits and the distributional benefit of providing homes at sub-market rents; and
- **Transaction costs** associated with the sale of the property through the VRtB.

[1] Pg, 64 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661480/autumn_budget_2017_web.pdf

2.2 These elements are in line with HMT's Green Book Appraisal guidelines and MHCLG's own published Appraisal Guide, and follow a similar approach taken to the economic appraisal in the published Impact Assessment following the reinvigoration of Right to Buy in 2012.

2.3 **The cash transfer:**

2.3.1 Although a transfer from central government to the private sector has a fiscal cost, in economic analysis the value is typically estimated as zero because the cash cost to one party is exactly offset by a cash benefit to another party. In this case the Government transfers the full value of the VRtB discount to the housing association. For context the average statutory RTB discount in England in 2017/18 was £60,370 (MHCLG live table 682).

2.4 **The value of homeownership to the tenant:**

2.4.1 The value of the VRtB discount to the tenant is estimated by comparing the cost of renting in their current situation to the costs and benefits of owning their home after purchasing their property.

2.4.2 Following Green Book guidance, a distributional weighting is applied to this value because housing association tenants have, on average, lower incomes than the general population, and Green Book analysis assumes that households on lower incomes value each additional pound of income more than those on average incomes. (In other words, they have a higher *marginal utility of income*.)

2.4.3 This distributional weighting is based on the difference in expected income between tenants purchasing through VRtB and someone on average income. The distributional weight is estimated to be around 0.7 which means that for every £1 of subsidy, tenants exercising their VRtB are estimated to benefit from an additional welfare gain of 70p on top of every £1 of benefit.

2.5 **The economic value of the replacement homes built to replace those sold – housing supply:**

2.5.1 The sale of homes under the VRtB generates income for housing associations, some of which they will invest in building more homes. The scheme assumes that housing associations will deliver an additional home through new supply nationally for every home sold, thereby increasing overall supply.

2.5.2 The benefit of new housing supply is valued, in accordance with well-established Green Book principles, using land value uplift, which is an estimate of the net private benefit of new housing. The land value uplift captures the net increase in value as land is brought into use for housing, compared to the value of the land if it had remained in alternate use e.g. agricultural/industrial. (An MHCLG publication showing how Valuation Office Agency estimates of land values are used in policy appraisal can be found here.)

2.5.3 The total land value uplift, when applied to every new unit of housing, estimates the gross benefit. The direct economic benefit of the policy, however, can only be estimated by assessing the net effects or the net additional housing. Additionality is estimated by calculating the gross impact of a policy and subtracting any deadweight (housing that would have been delivered anyway).

2.5.4 Land value uplifts are site specific and vary significantly by geography. However on average they amount to around £100k per home at a national level.

2.6 **Other economic benefits of the replacement homes:**

2.6.1 Although there is a net increase in overall housing supply, there is not expected to be a net increase in the amount of *social* housing as a result of this policy. However, there are additional benefits from the replacement social homes based on the assumption that the tenants who have bought through the VRtB offer would not have otherwise been able to buy and would have remained as social tenants. Therefore the replacement homes are genuinely increasing social housing available to those on housing waiting lists.

2.6.2 The benefits from the replacement units are included in the value for money analysis. These include the distributional benefits of providing homes at sub-market rent to people on below average income i.e. providing homes to people on housing waiting lists who may otherwise be claiming local housing allowance in the private rented sector, living in overcrowded conditions or in housing need in some other way. Again, the distributional weight of 0.7 is used to estimate the additional welfare gain to tenants as a result of paying sub market rather than market rents (net of any Housing Benefit payments received). For context, the average affordable rent of new lettings in 2017/18 was £123 per week compared to average market rent of £191 per week (CORE, 2017/18 [2]) .

2.6.3 Health benefits associated with increasing the level of social housing based on the benefits of reduced overcrowding and rough sleeping. These benefits are estimated to amount to well over £2,000 per home in present value terms over 30 years which is explained in detail in the MHCLG Appraisal Guide.

2.7 **Transaction costs:**

2.7.1 The transaction costs associated with completing each VRtB sale are estimated to be around £2,000 for the housing association.

3. Conclusion

3.1 In summary, funding VRtB is expected to result in a significant net economic benefit. The key benefits are: to the old tenant now becoming a homeowner; to the new tenant who used to be in the private rented sector; and the economic benefit of increased housing supply. The cumulative benefit far exceeds the economic costs associated with the transaction.

3.2 Furthermore, although the fiscal cost of funding the VRtB discounts does not feature as an economic cost in the analysis, we note that the net economic benefits are expected to exceed this direct fiscal cost to Government.

3.3 On that basis we conclude that funding VRtB is good value for money.

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[2] Table 2di
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/759616/CORE_Summary_Tables_2017-2018.xlsx