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Mixed Motives? The impact of direct public funding for private developers on not-for-profit housing networks in England.

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Abstract

The reform of the capital allocation process for new social housing provision in England, which enables private sector firms to take a more leading role alongside or in partnership with existing non-profit providers in the development of social housing, is gathering pace. The creation of a 'mixed economy' in social housing provision and, potentially, housing management provides a challenge to existing modes of working and inter-organisational behaviours in housing networks. After briefly explaining the nature of the change in policy, this paper seeks to interpret and anticipate the impact of increased private sector activity in a field previously populated by non-profit actors. It does so by attempting to integrate those elements of the literature of network governance and organisational economics concerned with motivation and 'steering'. Drawing on the investigative framework that this provides, the paper reports on some of the initial research that the authors have undertaken among actors in the field to throw light on the current and expected impacts of the policy change on social housing networks and on the inter-organisational relationships that they contain. It concludes with a discussion of the degree to which the anticipated impacts on existing networks are evident in practice and whether, as a result, the investigative framework used is both useful and appropriate.

Key Words: social housing investment; mixed economy; organisational economics; network management

Introduction

This paper seeks to make a contribution to the debate about competition in social housing provision in Europe (Elsinga et al 2006, Oxley et al 2007,) by considering a recent reform in procurement of new social housing in England intended to expose non-profit providers to direct competition from the private sector. While this reform, introduced by the Housing Act 2004, is still at a relatively early stage of implementation, some issues arising from this attempt to create a mixed economy of production of social housing are already evident (Campbell Tickell, 2006). This paper draws on some concepts from the literature on network governance (Kickert et al 1997, Koppenjan and Klijn 2004) and organisational economics (Nygaard et al 2007 add further references) to theorise these changes and uses some preliminary interviews with some of the actors involved to assess the significance and likely impacts of this reform.

As a result of two decades of reform across Europe the role of social housing has been both diminished and transformed (Primeus et al 1999). Part of this transformation has involved changes to the nature and mode of operation of social landlords which have become more commercial and market orientated and more focused on financial and asset management (Gruis and Nieboer, 2004, Gruis and C 2007). Another aspect has been the creation of mixed economy or unitary markets (Kemeny 1992, 1995) in which non-profit providers co-exist with profit distributing landlords (Elsinga et al 2005). While there have been very distinctive national paths in the allocation of responsibility for social housing provision between state, non-profit and market sectors the tendency for mixed economy markets is increasing. Indeed some of the more fundamental challenges to social housing organisations have come from pressures to create 'a level playing field' between non-profit and market providers principally in relation to the involvement of social landlords in the provision of 'market housing' (Elsinga et al 2006, Gruis and Primeus 2006). In the case under study this process is reversed with market entry by the private sector being stimulated by a more minimal form of regulation (based on contract) whilst existing housing association players remain subject to more comprehensive regulation; a dualism which has been seen as 'not sustainable in the longer term' (Campbell/Tickell 2006 p. 5).

Discussions of inter-organisational relationships in mixed economy markets has tended to be conducted around rather abstract notions of competition but recent contributions have begun to unpack competition into components such as rivalry, risk and substitutability (Oxley et al 2007). This work begins to make some important links between economic frameworks and actor motivations, perceptions and behaviour. For example Oxley et al note that for competition prescriptions to work 'SHOs do need to see themselves as rivals and be motivated by improving their share of the market' (2007 p. 8). This focus on perceptions and motivations is important because it indicates a recognition that markets are socially constructed and that how institutions act depends on both formal and informal rules and the understandings that actors bring to inform their action. In this paper we shall develop this focus on understandings and motivations by drawing on two bodies of theory that we believe have some purchase on these questions.

The paper is divided into four further sections. After briefly outlining the legal and administrative background to market entry by private developers (2) we explore the relevance of concepts from network governance (3) and organisational economics (4). We then discuss the application of the concepts to intepret the results of some preliminary scoping interviews (5). By way of conclusion we discuss how the concepts could be operationalised to inform further research.

Background

For 30 years policy on eligibility for capital grants to build new social housing in England remained fixed; the only eligible bodies for funding introduced by the 1974 Housing Act were non-profit distributing. Once subsidy of local authority construction had been phased out in the early 1980s, this left housing associations with a monopoly new provider position. Following abortive plans to introduce grant for private developers in 1996, the restriction on private sector eligibility was eventually lifted in 2004 alongside wider reforms of investment in new social housing that reduced the number of housing associations directly funded to around 70 (Mullins, 2005). So in a short period housing associations were faced with both strong internal competition and new external competition

While the Housing Act 2004 enabled funding to be made available to private sector developers, implementation was through two related programmes. First New Partnerships for Affordable Housing was a small-scale pilot of £200 million intended to identify the extent of private sector interest. Second, and more significantly, the 2006-8 National Affordable Housing Programme of £3.9 billion was open to both private and non-profit providers to bid alongside one another, or even together.

The (then) Chief Executive of the funding body responsible was able to claim in June 2006 that *'from a standing start a little over a year ago, we have successfully created a new market in the supply of affordable housing'*. The pilot programme had attracted 170 expressions of interest and 11 private sector bids and 8 joint bids from housing associations with private sector partners were shortlisted. Without time for evaluation of the pilot open competition for the 2006/8 programme resulted in nine private sector partners being selected, although their total provisional allocation was only 2% of the programme. Nevertheless, as contracts were signed there was a flurry of press releases for example '*UK's Largest Housebuilder* (Persimmon) *agrees contact terms for $16.5 million programme to build 930 homes* (Housing Corporation, June 2006).

While these changes have been presented as *'a radical departure'* (Cambell Tickell p.3) in promoting external competition for housing associations in their development role, an alternative interpretation would be that this is a relatively minor re-arrangement of the supply chain. Social housing has always been built by private sector developers and managed by housing associations. Now it is possible for developers to receive funds direct from the government to do this rather than via contracts with housing associations. An interesting indication of how fundamental the change is will be whether homes

procured in this way end up still being managed by housing associations or whether developers will set up alternative arrangement for their disposal and management.

An evaluation of these arrangements to facilitate market entry by private developers was published in December 2006 (Cambell Tickell, 2006); its focus was mainly on procedural effectiveness and the scope for improvements. However, some of the material lends itself to network management and organisational economics interpretations.

Network management interpretations

Housing provision in England, as elsewhere, is managed through an amalgam of market, hierarchical and network arrangements (Mullins, 2007). While markets are increasingly dominant forms of organisation for funding, developing and allocating most types housing, these market processes are generally underpinned by hierarchical and by network forms of co-ordination. For example the planning system based on hierarchical application of rules and procedures by local authorities with a national backstop of the Planning Inspectorate has a crucial impact on access to and price of land affecting all market based housing transactions. Similarly the procurement process for private market housing is often subject to supply chain relationships which may exhibit network type relationships such as partnering agreements between components suppliers, the various construction trades and investment bodies.

Procurement as an activity occurs at the interface between hierarchies and markets; with commissioners using rule based criteria to decide on whether to 'make or buy' and how to arrange any purchases. As Bovaird (2006) points out public procurement nowadays is unlikely to involve open market competition and may involve relational contracting (with a single commissioner and provider), partnership procurement (with several commissioners working together with a single provider) or even distributed commissioning (in which end users such as community groups may be involved in co-production or sub-commissioning). An example of the latter given by Bovaird involved a community trust acting on behalf of residents in commissioning community services using funds agreed with a property developer as a condition of awarding planning permission for a scheme of 400 new homes. These emergent forms all have some elements of network relationships underpinning the hierarchical intervention in markets.

Procurement of new social housing is one such example of a coordination process that has a combination of the three forms of coordination. In England a single national body, the Housing Corporation, sets the criteria for purchasing and the rules for eligibility. Strong hierarchical steering is possible because this body is both the monopoly public funder for new social housing and the regulator for the bodies managing such housing. Nevertheless, there are also market and network processes at work; housing associations have used market type mechanisms to contract with housebuilders to deliver the programme. Meanwhile the housing association sector has been quite strongly structured by network type relationships between members of the trade body, the National Housing Federation; who have moulded common values and identities through activities such as

the rebranding of housing associations as ‘ín business for neighbourhoods’ in 2003 (National Housing Federation, 2003).

Historically steering has been used to restrict eligibility for funding to non-profit distributing housing associations but has enabled a fairly wide range of associations (until recently around 400) to be directly involved. The recent changes involve both a significant reduction in the number of directly funded associations (to 70) and the entry of new competitors formerly excluded. These changes have had important network effects, with for example an acceleration in the formation of mergers and alliances as associations sought to maintain links with the 70 associations selected as investment partners (Mullins and Craig 2005).

Why and How?

One interpretation of the reversal of policy in relation to providing public funding for private sector developers would be that it was intended to overcome some perceived problems with the existing network of housing association providers. In network management terms the type of steering we are observing here involves interventions at the level of network constitution (Klijn and Teisman, 1997) to influence existing actors and their interactions in ‘policy games’. By deactivating’ existing actors and ‘selectively activating’ new actors it may be possible to bring new resources into play, to increase variation the network and to change the frame of reference of existing actors. This is a strategy that may be used where a network is seen as being closed to new ideas, where members generally share a common frame of reference and culture and where they have veto power to resist other forms of steering (Schapp and van Twist, 1997).

Also at the level of network constitution we can see the use of legal and economic instruments (de Bruijn and ten Heuvelhof, 2007) to reshape rules of the game by bringing profit distributing and non-profit bodies into new forms of interaction and by constructing a new arena (the National Affordable Housing Programme) in which the activated parts of both networks meet to play policy games.

The preliminary evaluation by Campbell Tickell provides some support for this interpretation of why and how these reforms were enacted. The summary refers to ‘new powers under the Housing Act 2004’ (legal instrument), ‘changes to grant systems’ (financial instruments) that have ‘brought in a new group of players that operate on quite a different basis’ (selective activation, variation, and a new frame of reference). Furthermore there is seen to be a need to increase variation further by encouraging a wider range of types of private body to engage. ‘Although a real start has been made a process of positive engagement with a wider range of commercial organisations, and in particular property investment or management companies is necessary to attract new players. At present the new approach has attracted little interest other than from housebuilders that see it as an adjunct to the development of sites for market value sale’(p.4). This fits well with Klijn and Temeer’s (1997) clarification that selective activation is not just about allowing entry of new actors into the game, but also about timing and promotion to maintain their attention and selection of those actors with the

most indispensable resources to participate. If the aim is to extend rivalry and contestability to all areas of social housing provision then it is clear that different types of private actors (such as real estate investors and property managers) need to be activated.

What Next?

Thus network management theory provides a reasonably plausible explanation of why and how market entry by the private sector occurred. But the more exciting implications of network management perspective is that changing the network constitution and selectively activating and deactivating the actors will begin to change the ways in which actors behave and network games develop. There may be blockages as a result of actors continuing to maintain distinctive frames of reference or operating with different motivations (Schaap and van Twist, 1997). Then too there are likely to be impacts on network rules and structures as a result of new perspectives and interests being introduced to network games (Termeer and Koppenjan, 1997).

Network management theory suggests that an active management approach will be required to tackle some of the blockages that may arise. Communication instruments may be required to enable common language to develop within the network while recognising that motives and values of actors may remain very different (Temeer and Koopenjan, 1997). Covenanting may be used to explore the motives, resources and conditions of different actors, to build support by changing the way in which the task is presented to create incentives to participate and to meet the interests of actors. Game management involves maintaining the attention of the actors, and recognising that actors may be involved in other games.

We can see from the Campbell Tickell evaluation that a process of mutual adjustment was occurring between the Housing Corporation and the new entrants. The evaluation refers to blockages resulting from formal rules and ways of doing things in the public funding procedures: ‘non-RSLs found the systems and particularly the Investment management system challenging. They have been critical of the complexity of the decision making process and the amount of information required’ (p.4)

The need to reframe procedures ‘to be more closely attuned to the realities of the private development process’ (p. 5) is indicative of a more profound adjustment of perceptions on the part of the Corporation. Even more fundamental to the different cultures and assumptions is the need to overcome concerns amongst non-RSL bidders about the disclosure of commercially sensitive information under the Freedom of Information Act’(p.6). Thus as the game progresses it is possible that the rules, procedures and culture within this arena could change to accommodate the interests and preferences of the new entrants. It will be interesting to see what impact such changes will in turn have on the strategies and behaviour of the existing housing association actors. Will they internalise norms about competition and commercial confidentiality and how will this impact on their accountability to their publics and the retention of trust and legitimacy?

Adjustments requiring adaptation by existing actors were also apparent in the recommendation that 'the use of different regulatory systems for organisations providing and managing social housing is not sustainable in the longer term and if a contractual approach is to be maintained for non-RSLs then such an approach should also apply to RSLs' (p.5). This could also have profound affects on the identity and operations of housing associations.

What the evaluation does not touch on particularly and which we would see as a longer term research topic is the extent to which change will occur through mutual adjustment between the new entrants and existing players directly rather than through the intermediary of the Housing Corporation. That is to say will perceptions and behaviour change as a result of mutual learning through joint ventures, staff transfers, supply chain adjustments and the like? Will we begin to see a single professional field of (social) housing development with recruitment and staff transfers between public and private agents. If this is the case the prediction by the director of one private sector housebuilder that in ten years time there will be little observable difference between a large housing association and a private sector social housing developer might come to pass.

Organisational Economics Interpretations

In this section some ideas from organisational economics are brought to bear on the issues of why the change of policy to direct funding of private developers might have taken place, the benefits that might be anticipated from such a move and some of the costs, in the broadest sense, that might arise from such a change. The section then raises some critical questions concerning the extent to which the simple framework presented here is adequate for the interpretation of inter-organisational relationships which are subject to exogenous change.

Why and How?

The first argument that might explain the introduction of further private sector involvement in social housing production hinges around the presumed greater economic efficiency of private, for-profit firms when compared to non-profit organisations. This frequently stated, though contested, argument primarily concerns the incentives to greater efficiency that the presence of a residual claimant to the firm's surpluses – shareholders, for example – gives to managers. The need to make profits leads management to control costs, search for more innovative methods of production and fulfil consumer demands, and more generally, to attempt to perform better than competitors. Failing to meet the requirements of the residual claimant and the capital market exposes managers and the work force to the threat of replacement. The absence of a residual claimant potentially severely weakens these incentives for non-profits. Although as Elsinga et al (2005) point out alongside these critiques of non-profits inefficiencies there are those who argue that non-profits are by definition cheaper because there is no leakage of profits and all of the investment can therefore be focused on service delivery (Kemeny, 1995).

However, differential efficiency arguments alone do not provide an adequate explanation why government should want to encourage private firms to compete for and take up grant rather than, as has previously been the case, fund their 'agents', the HAs, who then contract with the firm. The efficiency benefits of employing profit making firms to supply new development could in principle be realised by making those firms compete with each other for the contract with the HA. Furthermore if the recipe for efficiency is to make the 'market for grant' itself more competitive then arguably this would be better achieved by encouraging more HAs to bid, rather than fewer, as the procurement efficiency strategy of 'buying big' and minimising the number of transactions and agents pursued by the Housing Corporation since the 2004 Investment Partnering reform. Separating competition in this way between two arenas (for grant and for contacts) would avoid the additional costs of the control or regulation of private producers in receipt of subsidy to ensure that the subsidy is not simply absorbed in higher profits or a decrease in X-efficiency, with no gain to government and tax payers. These particular costs do not need to be incurred in grant aiding HAs because of their explicit non-profit distribution and social objectives.

A stronger case for awarding grant directly to private firms might be that direct funding enables the firm to more fully exploit the benefits of being in control of the development process with consequent opportunities to be more innovative and to control costs. This contrast with a situation where HAs might use the grant to (indirectly) contribute to costs of the wider services they provide rather than just the construction of new homes. Thus, the transaction costs involved in developing new housing when a third party such as an HA is significantly involved can be reduced. Further transaction cost savings can be made by government and by the firm in dealing directly with each other rather than primarily through the HA as agent.

What next?

These putative advantages, however, need to be considered in the light of potential risks to the government of directly funding private firms. These can be interpreted by drawing upon elements of Principal-Agent (P-A) theory, at this stage in its simplest form. P-A theory suggests that at least two problems might arise from direct contracting in this way. The first is adverse selection of A by P and the second is the question of moral hazard.

The possibility of adverse – or simply incorrect or sub-optimal – selection of an A by P arises primarily because the former has private information about themselves, their abilities and their strategies which is not (readily) available to the latter. Thus, as Laffont and Martimort (2002) explain, where a task, such as the production of social housing, is being delegated to A:

'The exact opportunity cost of this task, the precise technology used and how good the matching is between the agent's intrinsic ability and this technology are all examples of pieces of information that may become *private knowledge* of the agent. In such cases…there is *adverse selection.*' (p28: italics in the original)

Avoiding the consequences of adverse selection through the design of contracts and mechanisms that cause or incentivise A to reveal their 'qualities' to P has generated a vast literature (for a good summary see, for example, Salanie, 2005, especially Chapters 2 and 3). For the purpose of this paper, we can note that there are a number of practical steps that P can take to minimise the impact of adverse selection on the choice of the private firm to be funded. For example, where performance and/or output is amenable to measurement, as is arguably the case with many elements of housing development and construction, P can insert penalty clauses for non performance or non compliance into the contract or can make A take out insurance as a condition of any agreement, whereby specialists in the insurance market assess the risk of non-performance by A and charge accordingly. Failure to secure insurance at rates which make bidding for and being awarded the contract commercially viable for A removes them from the 'game'. P can also require sureties or the up front depositing of funds which will be non-returnable in the event of non-performance. This is equivalent to the giving of hostages in game theory, where for A hostages are '…assets or property titles that lose most of their value outside of the relationship' (Salanie, 2005, p162) in, for example, the case of default.

There are even more straight forward and readily available actions which can mitigate the adverse selection problem. P can check the relevant experience of A through references or via information networks, and in the case which interests us here, can readily find out A's previous involvement in social housing provision at the sort of scale that will be required, and assess the outputs and quality of previous performance. Such information seeking activities may be costly for one or both parties, and indeed can be rightly regarded as part of the transaction costs of contracting, and it is interesting to note that Campbell Tickell (2006) found that the amount of pre-qualification information required from private developers by the Housing Corporation was regarded by many of the former as excessive and onerous. Nevertheless, this process may be arguably less costly, certainly for P, than subsequent non-performance by A.

Given these (partial) remedies for adverse selection, it is the second issue, that of moral hazard that may be more pertinent to this policy area. Moral hazard or 'hidden action', following Laffont and Martimort (2002, Chapter 4), arises where A can take an action which is unknown to, or unobservable by, P, or, less strictly, is difficult for P to verify. If it is assumed that A wishes to maximise profits, such actions will be taken where they increase the profitability of the task to A at the cost of, or with no benefit to, P. The classic example here is where the effort that A puts into a task is unobservable by P and so A might shirk or cheat while blaming other, perhaps equally unverifiable, events or contingencies for the lower level or quality of output that results. Again the literature suggests methods to detect sub-optimal or at least second best effort from A.

It is important to put the risks of moral hazard into a longer term perspective. The value of the current contract to A and the importance of reputation and past performance to A for future contracts with this or another P, it is quite reasonable to suggest that A may not wish to cheat or take other detrimental hidden actions. In this sense, the contractual relationship between P and A is not a 'one period' game. The perspectives provided by

our earlier review of network management ideas in which the outcomes of earlier games affect perceptions and behaviour in later games are relevant here.

Even so, a remaining concern is that any subsidy paid direct to a private developer might 'overcompensate' for the revenues otherwise lost by the firm in producing an output to be sold at below market prices and thus benefit residual claimants. If such 'excessive' surpluses are made as a result of the efficiency of the developer it might be argued that the party which is the final recipient of (part of) the grant is purely a distributional matter – the properties have still been produced as agreed under the contract. However, this distributional issue is important in the light of the purposes of the grant – that is, given the preferences of the taxpayer – which can be characterised as that improving the welfare of low income households by providing housing for as low a level of grant as possible. If an additional surplus arises due to efficiency savings on the producer's part, a lower level of grant could have been paid. Problems arise where these surpluses can only be identified, if at all, *ex post*, after the project is fully completed. This would suggest that the grant be paid at that stage also when all relevant costs and revenues have been identified. Further issues arise, of course, if the grant is just sufficient to incentivise participation by the developer in the programme so that any reduction would lead to exit and consequent loss of all efficiency savings.

Under current arrangements where an HA is the agent, the use of grant is accounted for and any surplus is 'recycled' by counting against future grant entitlement. The regulator will be tasked with ensuring that the contract with the private firm in some way mirrors the arrangement with HAs so that any surplus accruing as a direct result of the subsidy can at least be identified and appropriate remedies or redistributions applied. Questions of information and regulatory competence are likely to arise in this situation.

Conceiving of some of the issues that arise, or are likely to arise, in this area from a P-A perspective is of value given the context of greater competition and a greater reliance on the market in social housing provision. However, in its simplest form as stated here, the approach does not seem to capture some of the concerns of those in the policy arena concerning the impact of directly funding the private sector on existing arrangements for social housing production. Is this form of funding simply replacing one former P (or 'super agent'), the HA, with another, the private developer, and one former A (or 'sub agent'), the developer, with another, the HA? How does this square with the partnership ethos and practice discussed above, or is 'partnership' simply a loose term for a series of complex P-A relationships?

Williamson (1985) has argued that that the so called 'hybrid organisations' which lay between the extremes of the organisational spectrum of hierarchy and market, reading the latter as predominantly P-A relationships, were transitory and unstable tending towards market or hierarchical forms in the longer run. Few would now argue that this is the case. Thus Williamson (1985):

‘…I was earlier of the view that transactions of the middle kind were very difficult to organise and hence were unstable…I am now persuaded that transactions in the middle range are much more common.’ (p 83)

More recently, Menard (2004) in a seminal paper has examined the characteristics of a number of hybrid forms, among which he identifies (p348-350):

- Sub-contracting
- Networks, which are recurrent contractual ties among legally independent entities
- Partnerships, which mix the ‘characteristics of an integrated firm and characteristics of a network’ (p349)
- Alliances

He also points out that it is quite usual for members of partnerships and networks to compete in some areas and co-operate in others, which is a key feature of HA partnerships and consortia and, now, of private developers and HAs. Thus:

‘…hybrid arrangements…are rooted in a mix of competition and co-operation that subordinates the key role played by prices in markets and by command in hierarchies.’ (Menard, 2004, p353)

It is through exploring the incentives and governance arrangements that make these organisational forms effective and stable that the bridges between organisational economics and network analysis could be built. Some of the key questions suggested include:

1. Networks and partnerships imply mutual dependency but also give rise to the possibility of opportunism. How is this policed and mitigated?

2. What form of relationship specific assets (for example, human, physical, reputational) do members of social housing networks invest in and why? Does this ‘lock in’ members effectively into the network? Does it also give the possibility for ‘hold up’ by powerful members? How is this affected by competition from outside the network?

3. How in other fields (franchising, collective trademarks) is stability maintained while competition between members is also expected and tolerated? There may be valuable parallels in those areas which may indicate the likely reactions of HA networks and partnerships to competition from private developers where a network member is also in a partnership arrangement with that developer.

Even at this very early stage of our research, some provisional hypotheses based on these sorts of consideration suggest themselves. These are discussed in the next section.

Some Hypotheses

Considering both bodies of theory we constructed some hypotheses to assist in the development of research tools to be piloted in some scoping interviews. These hypotheses include:

1. Private sector will introduce new (more efficient) practices
2. Incentive structures provided by profit will increase competitiveness which will affect behaviour of non-profit actors
3. Selective activation will affect motivations and behaviour of all actors
4. There will be a gradual blurring of boundaries and convergence of organisational behaviour
5. Changes in policy arena will affect structure of network (mergers, joint ventures and alliances)
6. Changes to frames of reference will occur through organisational learning (across networks, within joint ventures)
7. Moral hazard and transparency concerns will increase regulatory response
8. Difference of motivation between profits and non-profits will still show up in different behaviours
9. Steering strategies, contracts and regulation will have to vary to reflect different actor motivations
10. The two sectors will remain in different networks but compete in same arena

Testing the Hypotheses – Initial Explorations

As noted above, private developers became eligible for direct funding for social housing provision under the 2004 Act and were effectively only brought into the National Affordable Housing Programme in 2006 – and then on a relatively small scale. Consequently, there is at present little evidence available to test the hypotheses in any rigorous manner, particularly since some of the hypothesised impacts of the policy change would be expected to manifest themselves over a longer period of time than has elapsed to date. Nevertheless, there is sufficient experience of public-private working in the production and delivery of social housing for key players in the field to have developed perceptions about the reasons for the change in arrangements and expectations about the likely impacts.

The scoping stage of this research therefore ascertained the views of senior representatives of three of the organisations playing a key role under the new arrangements. These were the Housing Corporation, an HA which became a lead partner for investment purposes under the 2004 partnering arrangements and a large private developer with significant experience of working with the Corporation and HAs under both the previous and now, as recipients of direct funding under the 2006-2008 programme, the new regime. Semi-structured topic guides were developed covering the main hypotheses and adapted to the position of each interviewee. The main topics covered were views and experiences of previous arrangements, perceived reasons for the

changes, expectations and perceived outcomes of the changes, regulatory issues and early experience of the new arrangements.

How and Why?

Discussions with the three participants concerning Hypothesis 1 centred around the extent to which expectations that the changes would result in increasing efficiency had been a major reason for introducing the new policy in the first instance. All three participants had little doubt that the driving force behind the change was the principle that competitive, profit driven organisations would tend to be more efficient in housing production than not-for-profit organisations. This belief appeared to be confirmed by a comparatively poor performance by traditional housing association procurement in 2003-2004 in terms of the number of social housing units produced in return for the grant provided to HAs by the Housing Corporation. Further, there was increasing pressure to improve performance in housing production and output from major reviews of housing supply (Barker, 2004) the land use planning system (Barker, 2006) and the more general public sector efficiency agenda (Gershon review, 2003). The tone of these reviews, stressing the importance of liberalising public systems of land allocation and reducing constraints on market operations had, of course, a clear resonance with broader liberalising tendency in public services which has been a feature of the UK economy, and many in Europe, for over two decades.

However, it was also argued by one participant that it was precisely these concerns over possible inefficiencies in the production of social housing that had led the Corporation to introduce the Investment Partnering approach in 2004, noted above, which concentrated funding for new development on a limited number of HAs. It could be argued that this approach had not yet been in place long enough to demonstrate fully whether it could deliver the required efficiencies and greater value for money, even though an early evaluation of the programme indicated that developments under these arrangements required nine per cent less grant, on average, than under the 'traditional' programme (Chartered Institute of Housing and Tribal HCH, 2005). Hence, a view was expressed that it was '*ideology rather than evidence*' which prompted the change, and that this ideological stance was given additional support through active lobbying, both in public and in private, by private developers' organisations anxious to receive direct funding. The emergence of active support from these organisations is in itself interesting since one of the main reasons that a similar proposal for grants to developers was abandoned by the previous Conservative government in 1996 was that there had been little interest from developers at that time (Mullins and Murie, 2006).

What Next?

Interviewees suggested that gains in efficiency could arise in practice from direct public funding of private developers in two main ways. First, in operational terms, being the grant recipient allows the developer greater control over the development and construction process, greater certainty over costs and prices, more opportunity to use their expertise to the full, and enables them to reduce resources allocated to dealing with a

‘third party’ in the relationship – i.e., the HA. This last consideration can be quite significant in situations where an HA might otherwise be tempted to make changes in the development brief or specification during the construction process that impose additional costs on the developer. It might also be argued that where a group or consortium of HAs is involved, which can be ‘*impenetrable*’ for those managing the development process in the private firm and lead to lengthier and more opaque decision making. However, this ignores the structure of the Investment partnerships where just 70 housing associations are clearly accountable as lead partners.

Another argument raised is that most HAs approach development on a scheme-by-scheme basis, often relying on the release of public land or on private landowners being prepared to sell specific plots designated for (some) affordable or social housing. If, for whatever reason, the scheme fails to proceed, the HA then has to restart the process. Large developers, in contrast, are, by the nature of their business, constantly searching for, pricing and banking land. Consequently, in the event of a development on one site being unable to proceed, there is the opportunity for a rapid substitution of that site for another with minimal delay. However, this argument probably exaggerates the difference from large developing associations who increasingly operate in a similar way, with the ability to land bank being seen as one of the main advantages of increasing organisational scale.

Another perceived advantage that can arise from direct funding of private developers is strategic, and indeed may be relevant only in the case of larger developers. It may also be essentially a private benefit to the firm. It arises from participation by the firm in very large, often regeneration, projects under many of which there is a greater certainty of funding because they are usually funded on a programme rather than individual scheme basis. These projects represent risky, but potentially profitable, opportunities for the developer. As a recipient of grant directly, a developer can enter into negotiations with the project ‘principal’ – the local authority, for example - without having to rely on or work through an HA, and, as importantly, has greater power in those negotiations because they are holding grant. Having received grant for (part of) such a project, or for past projects, also gives the developer credibility and signals to the principal that the ‘agent’ (developer) has been approved as a worthwhile partner on the basis of past performance. Thus, being so approved ‘*ticks all the right boxes*’ for those parties with whom the developer is negotiating. However, again larger housing associations would argue that this is precisely the business that they are in.

Hypotheses 2 through 5 suggest that the behaviour of non-profit and for-profit actors in the system will change and that one outcome may be that they will increasingly adopt behaviours and perhaps organisational forms that will blur distinctions between them. Here, it can be noted that organisational forms within the non-profit sector have already been changing in the absence of direct funding to for-profits in response to a number of financial and other imperatives external and internal to individual HAs. As the examples of landbanking and large scale regeneration schemes discussed above illustrate there may already be considerable convergence in roles and practices between large housing associations and private developers. This is as a result of growth through merger which is

affecting not just the largest associations but all levels of the sector (Mullins and Craig, 2005). It has been argued that Investment Partnering approach added to these pressures, with 54% of HAs in a recent survey suggesting that the programme had made it more likely that they would merge or form a group structure with other HAs to compete for grant (Chartered Institute of Housing and Tribal HCH, (2005). This trend is likely to continue, according to some of those interviewed, as a 'natural' organisational response to increased competition. Indeed, this response may be one reason for the introduction of competition, since it was argued that in some regions the structures created by HAs had led to a significant reduction in the real competition for grant.

Further, the private sector interviewee argued that in becoming increasingly involved in building housing for market renting and for sale at market prices, and in forming consortia for land purchase and banking, HAs were clearly '*entering our territory*', rather than private firms entering theirs. Engagement in market activities by HAs in order to cross subsidise social housing provision may well increase if allocations to private developers also increase. Some HAs are already questioning the attractiveness of social housing development with subsidy levels moving down to 30% of costs; does this compensate for the attendant restrictions in who they must let the properties to and how much rent they can charge? Additionally, any future change in the grant system to that of the deficit financing of schemes, where the grant awarded depends on an audit of the actual costs of a scheme compared to its future revenues, is likely to lead to more HAs developing with little or no public funding, enhancing the attractiveness of these market activities.

A significant feature of the arrangements under the 2004 Act is that it opens up the possibility not only of private developers receiving grant directly but also that they might retain ownership of the properties, rather than selling or transferring them to an HA, and also manage the properties where they are for social renting purposes. This mirrors the discussion within the housing association sector when it was anticipated that large developing associations might **not** hold on to the homes they develop but might prefer to focus on development and transfer the homes to other HAs specialising in housing management. Although one private property management organisation has been approved as a social housing management provider, no private developer has yet pursued the option of retaining ownership and/or providing management services to date.

It would appear that at present private developers in receipt of funding are wary of the risks of retaining ownership (let alone providing or contracting out management services) of such properties, given the need to raise long term finance to do so and to continue to invest in and maintain them. Indeed a major contrast in the business model of property developers and housing managers is that the former is essentially a cash flow' business (borrow, develop, sell) whereas the later is more concerned with the long term asset. Continuing prospects for the growth in property values may enhance the perceived benefits to developers of holding on to assest rather than realising income, but even if in practice it does not, in opening the area of management to competition in this manner, the whole development and service provision 'market' becomes contestable. As is well

known, the threat of contestability can encourage greater efficiency in ‘incumbents’, even where the threat does not become actual competition.

There is also at least one example of a private firm providing housing for sale on their own site through government low cost home ownership (LCHO) schemes where the firm retains the ownership of the properties while the occupants incrementally ‘buy in’ to the equity. The firm has also designed a range of mortgage products which are offered to purchasers and argues that these prove more attractive than those available through appointed LCHO agents, who are usually HAs. The process is also said to be less complex and bureaucratic than when managed by the LCHO agents. The social objectives of the LCHO scheme are said to be safeguarded by operating this scheme through a wholly owned but separate non-profit subsidiary, which retains any surpluses for social housing purposes. Although no independent evaluation of this approach appears to be available, it is another indication of the possibility for further competition for HA business in areas outside of the development process itself. Thus, both HAs in developing market activities and private firms to taking the lead in traditional non-profit activities can be taken to indicate the blurring of organisational boundaries (hypothesis 4).

When considering the significance of increased competition and contestability in this area all three participants stressed that at present HAs still dominate in respect of grant receipt and social housing management. It is also important to note that much of the new social housing produced for sale and rent is provided under ‘section 106’ agreements. Under these arrangements, a developer provides some units of social housing on a site, or on another of their sites, in return for planning permission to build homes for sale on the private market. The social housing units are then sold to an HA for an agreed sub-market price, and purchased by the HA using grant, where available.

Notwithstanding the example of the private LCHO trust given above, this process requires co-operation and partnership between the developers and the HA. As might be expected, there is disagreement in this area as to where, underlying this relationship, the real power is vested. This may partly depend on who owns the site – if the developers own the site then, steered by the local authority responsible for granting planning permission or using the firm’s own contacts, they may approach a number of HAs seeking what is from the firm’s perspective the best deal. Where the HA owns, or has been given responsibility for, the site the HA may approach one developer with whom they have a history of partnership or a number of developers, seeking an agreement that best serves their own, or the wider social, interests. Either way, the importance for the discussion here is that this process in appearing to require an on-going non-adversarial relationship if both parties are to benefit over time is in contrast to the ‘new competition’ elements of the direct funding approach. Since partnership is argued by participants in this part of the study to facilitate learning and the accumulation of experience by both for-profit and non-profit organisations, it will be interesting to see if contestability in the other areas of activity has the potential for limiting or constraining learning in this way (hypothesis 6).

The final hypothesis (7) relates to the role of the regulator and the form of regulation where private developers are receiving social housing grant. There is a clear concern that profit motivated organisations could allow social housing grant to simply pass through to profits, in the form of costs reductions, and, thus, to shareholders with little or no benefit to taxpayers. This is perhaps one of the major reasons why public funding of private firms and organisations has not been a feature of UK housing policy to date.

The regulatory role and performance of the Housing Corporation is an area of some controversy (see Mullins and Murie, 2006: Chapter 7 for an overview) and is currently subject to the Cave Review. A number of submissions to that Review (Department of Communities and Local Government, 2007) argued that HAs have different motivations from the private sector so that its is crucial that if the latter is performing an essentially social role then it should be regulated in the same (though not necessarily the current) manner as HAs. Thus,

Private developers and RSLs should face a level playing field in terms of regulatory and contractual arrangements. (Birmingham City Housing Partnership, in Department of Communities and Local Government, 2007)

This could well prove problematic if the current regulatory framework, often criticised from within the non-profit sector for being over detailed and burdensome, is not reformed. As an indication, it is known that one of the private firms, a representative of which had been very active in lobbying for the policy change, received an offer of funding under the new arrangements and was in process of forming a joint venture with an HA to deliver the development. However, the regulatory expectations of the Housing Corporation in respect of the firm's activities were regarded as too onerous, and potentially commercially damaging, for the company and as a result the offer was refused. The member of the private firm interviewed for this study stated that there were potential problems with regulation, particularly in terms of the commercial sensitivity of the information that was, or could be, required and argued strongly that the Corporation's real concern should be with value for money – grant per unit of output – and not with the costs, profits and detailed progress of the firm's developments. He went on to add that the firm was already regulated by the market, its shareholders and, being a listed company, by Stock Exchange rules.

It is clear that the Corporation has in practice adopted a different approach to regulating grant aided private firms. Each scheme financed in this way is governed by a contract, a legal agreement that specifies building standards, timescales and milestones, and contains a requirement that an independent assessor should agree that all contractual terms have been met at the end of the development before the grant is paid. In this sense all the risks lie with the private developer, in contrast, perhaps, to the position for a grant aided HA, where the association receives 50% of the grant at the outset of the approved development. Particularly in this respect, the private firm would prefer a level playing field. Indeed, there is perhaps a double irony in that a number of those contributing to the Cave Review argued for some form of contract based regulation of HAs developing with public funding and minimal regulation of HA activities outside of this. In this sense, the

Corporation's response to regulating private firms in this context might benefit HAs if it is extended in the future.

Conclusions

This paper has begun to explore the potential impacts of what may be a very significant change in policy for social housing production in England. It has speculated on the reasons the policy was introduced, drawing on two bodies of theory and some key actor interviews. These speculations suggest that there was a belief amongst policy makers that selective (de)activation by restricting the number of non-profit actors involved and enabling competition from profit distributing actors would increase the efficiency of the procurement of social housing and bring new resources into the process. It appears unlikely that these beliefs were informed by more sophisticated concepts from principal agent theory relating to adverse selection and moral hazard or by network management concepts of mutual adjustment and changing actors' frames of reference. Yet it is precisely these aspects of beliefs, perceptions and behaviour that will determine the longer term impacts of these changes on the housing system. Changes to formal rules may be negotiated to make entry by the private sector more significant and to change the perceptions and behaviour of non-profit actors. The extent to which moral hazard and adverse selection can be guarded against will affect the extent to which the policy continues and the incentives for private developers to engage. There may be active engagement and collaboration between non-profit and profits distributing actors leading to mutual adjustment and learning or private and non-profit housing may continue as two very distinct networks.

We would concur with the conclusion reached by Oxley et al (2007) that in general, and despite the small scale entry by private developers the situation in England is currently one where market suppliers are not rivals to social landlords in the provision of social housing because they provide different services on different terms. However, the policy reforms reviewed in this paper could result in some changes to this situation and for this reason warrant close analysis. We have explored two distinct theoretical strands which we believe have some purchase on these questions and which might also benefit from closer integration. We recognise that more work on theoretical integration is needed, and this may in turn lead to further hypotheses. We believe that the paper makes the case for close analysis if the longer term impact of these changes.

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