Homes & Communities Agency

Chair email address: chair@hexagon.org.uk
(CC) Chief Executive email address: tmccormack@hexagon.org.uk

Dear Chair,

Please accept my apologies for the impersonal nature of this letter but I am writing to you to highlight the publication of our new analysis of cost variation across the social housing sector, *Delivering better value for money: Understanding differences in unit costs,* available on the HCA website, and to set out changes to our approach to regulating the Value for Money (VfM) standard.

The analysis shows that registered providers have achieved real terms reductions in headline social housing costs per unit over the past five years, in large part because the cost of maintenance and major repairs has declined with the near completion of the Decent Homes programme. However, it also makes clear that the sector will need to deliver a step-change in its operating efficiency over the next five years. The savings that providers are forecasting between now and 2020 in order to offset the impact of cuts in social rents are significantly greater than anything that the sector has achieved in recent years. If these cuts are to be achieved without undermining the pursuit of the sector's objectives of investing in new and existing homes and delivering quality services to tenants, then providers will need an intense focus on efficiency.

In this context, it is concerning that there is such a wide variation in headline social housing costs across the sector. Our analysis suggests that around half of this variation can be explained by observable factors such as a provider's level of supported housing activity, and differences in regional wages. However, half of the variation cannot be explained in this way. We recognise that not all aspects of a provider's business can be captured systematically in the data, and there will be some entirely justifiable drivers of costs that cannot be captured in this kind of analysis. However, this level of unexplained variation must, at least in part, be due to differences in the operating efficiency of different organisations.

We will therefore be reinforcing our focus on VfM regulation and will increasingly be challenging providers on their approach to optimising efficiency in the achievement of their objectives. We now consider compliance with the VfM standard as an integral part of our programme of In Depth Assessments (IDAs). Transparency remains a key element of the standard, and we will continue to expect providers to publish clear self-assessments for the benefit of a range of stakeholders. However, the IDA will allow us to focus not just on the transparency with which providers communicate their approach, but to seek assurance on how organisations are delivering VfM in practice. We regard a focus on delivery of VfM as a leading indicator of good governance. We will seek to understand how Boards assure themselves that they have a comprehensive strategy to deliver on-going improvements in efficiency, and ensure that they are

using their resources and assets in the most cost-effective way in order to deliver the business's overall strategy.

We take a co-regulatory approach to VfM, as we do to the regulation of all the economic standards. We are not seeking to specify how providers must use their resources or assets, or how they achieve the balance between driving down costs and quality of services or investment in social activities. We are not mandating a 'right' level of operating costs. However, we will seek assurance that investment decisions to deliver specified outcomes are rigorous and evidence-based.

IDA reviews will seek assurance of the provider's compliance with the VfM standard in the round, including how the individual provider maximises its return on its assets and how it makes decisions on the use of resources to maximise delivery of the organisation's objectives. However, we do expect that boards understand their costs, the main drivers of those costs, and why they are higher or lower than those of other providers. The regulator will therefore use a range of cost data, including those derived from providers' accounts and forecasts, in order to inform its engagement with providers in IDAs. Where data identifies that a provider has unusually high costs, we will seek assurance that the provider understands why this is the case, whether this is the result of a conscious business decision (high investment for high outcomes) and, if not, what the provider's plans are to reduce costs or improve outcomes.

I enclose a summary of your organisation's headline social housing costs per property, derived from 2015 Global Accounts data and broken down into key cost lines. This is set alongside the equivalent figures for the sector as a whole in order to provide context. I trust that you will find this of use to inform board discussions. We will seek comment and feedback, in the course of our engagement with the sector over the coming months, on how you make use of this analysis in your board discussions and on any additional comparative or contextual information that you would find valuable, including how we might best make that available in future.

I look forward to working with boards to deliver our shared objective of a viable, efficient and well-governed sector, with providers able to deliver value for money in the achievement of their social purpose and objectives.

Julian Ashby

Cost data:

Entity	Closing social housing units managed	Headline social housing cost CPU (£K)	Management CPU (£K)	Service charge CPU (£K)	Maintenance CPU (£K)	Major repairs CPU (£K)	Other social housing costs CPU (£K)
Hexagon Housing Association Limited	3,668	3.64	0.75	0.47	1.28	0.43	0.72
Sector level data							
Upper quartile		4.30	1.27	0.61	1.18	1.13	0.41
Median		3.55	0.95	0.36	0.98	0.80	0.20
Lower quartile		3.19	0.70	0.23	0.81	0.53	0.08

Provider - Key contextual information

Entity	% Supported housing	% Housing for older people	Provider type	Date of largest transfer	LSVT age	Region	ASHE regional wage index (England =1)	Group
Hexagon Housing Association Limited	6.7%	0.9%	Traditional			London	1.22	Hexagon Housing Association Limited
Sector level data								
Upper quartile	4%	15%						
Median	1%	8%						
Lower quartile	0%	4%						

Data overview

The tables above set out the unit cost data for each of the registered entities in your group, sub-divided into the major components of costs. Full details on the sources of the data are set out overleaf and are discussed in the unit cost analysis publication.

The data represents a headline reference point to understand costs relative to all other providers (with more than 1,000 units) in England. By comparing headline social housing costs per unit against sector quartiles, it is readily apparent which entities appear to have relatively high or low unit costs and the extent of divergence from sector benchmarks. The sector median shows the equivalent unit costs for an average provider.

Headline social housing cost per unit is broken down into its main five components: management, service charge, maintenance, major repairs and major repairs costs. By comparing each component line to quartiles, the cost position can be examined in more detail. For example, if an entity has relatively high or low headline unit costs it is possible to identify which particular cost lines appear to drive this. Further, component cost lines may inform conversations on about where within a provider's business there could potentially be most scope for efficiencies.

Boards should understand the unit cost data presented, which is derived from audited accounts. In particular, they should understand the reasons for divergence from sector averages. This is likely to require reference to other data sources, including more detailed information from provider executives.

In order to help inform discussions over how costs relate to provider's operating context, some key contextual factors are summarised for each entity. These factors – supported housing, region of operation, stock transfer status – have the closest statistical links to unit cost variation. Other potentially important factors have not been included because the data is not held by the regulator.

The tables give an overview of how operating context of each entity relates to the rest of the sector. This should help inform discussion on some of the reasons for relative unit costs, how far these can account for cost variation, as well as peer group selection. For example, high proportions of supported housing or operating in higher wage regions are associated with higher headline unit costs than average. Some factors are typically associated with certain component cost lines – higher major repairs costs are generally associated with stock transfers rather than supported housing for example. The relative wage levels in the region each provider holds stock is shown and may account for an equivalent difference in cost levels.

Some variation, especially for component cost measures, may arise from differences in accounting practices or measurement of stock. For example, a relatively low management and high maintenance cost could reflect divergence in the approach to accounting for overheads within these lines. However, we anticipate that such factors will only have a material bearing on relative headline social housing unit costs for a minority of providers.

Data sources and notes

All **unit cost measures** are drawn exclusively from Global Accounts data for 2014/15 submitted by providers to the regulator. Measures are discussed in the publication and are defined as follows:

> Headline Social Housing CPU = (Management + Service Charge Costs + Routine Maintenance + Planned Maintenance + Major Repairs + Other (SHL) Costs + Capitalised Major Repairs + Other social housing activities Other Expenditure + Other social housing activities Charges for support services / Closing Social Housing Units Managed
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> Management CPU = (Management + Service Charge Costs) / Closing Social Housing Units Managed
>
> Maintenance CPU = (Routine Maintenance + Planned Maintenance) / Closing Social Housing Units Managed
>
> Major Repairs CPU = (Major Repairs + Capitalised Major Repairs) / Closing Social Housing Units Managed
>
> Other Social Housing Costs CPU = (Other (SHL) Costs + Other social housing activities Other Expenditure + Other social housing activities Charges for support services) / Closing Social Housing Units Managed

Data on **key contextual factors** draw from several sources including the 2014/15 Statistical Data Return (SDR) submitted by providers to the regulator. As discussed in the publication, these measures reflect the factors with the strongest links to unit costs and are defined as follows:

> % Supported Housing (excl HOP): Number of Supported Housing, excluding HOP, units owned or managed divided by the Total Number of Social Housing units owned or managed, as reported in the 2015 SDR.
>
> % Housing for Older People: Number of Housing for Older People, including Care Home, units owned or managed divided by the Total Number of Social Housing units owned or managed, as reported in the 2015 SDR.
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> Date of Largest Transfer: For providers defined as LSVT within the Global Account. Where there has been more than one transfer into an entity it gives the date of the largest transfer, by tenanted stock, following HCA records of stock transfers.
>
> LSVT Age: Uses the date of the largest transfer to band LSVT entities by age, as used in the unit cost analysis. The three bands used are < 7 years, 7-12 years & > 12 years.
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> Region with 50%+ of social stock owned: Defined as the region where the provider hold more than 50% of its owned Social Housing stock as reported in the 2015 SDR. If no such region exists then the provider is defined as "Mixed".
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> ASHE Regional Wage Index (England = 1): An index calculated using data on relative regional administrative and construction sector earnings from the Annual Survey of Hours and Earnings (ASHE) and information on Social Housing units owned or managed by region as reported in the SDR. The England average is 1.

Data is shown for entities with corresponding data submitted for 2015 Global Accounts.