NFA submission to the Lyons Review

Summary

The NFA believes that ALMOs can play a key role in helping to deliver new affordable homes right across the country. Whilst we recognise that ALMOs will not be the volume builders of the future we believe that ALMOs and Councils could play a much more significant role in increasing affordable housing delivery and build at least 60,000 more homes over the next 5 years if they were allowed to make the most of their assets and business plans. The current housing crisis will not be solved by one route alone and we believe that every available route should be fully utilised in order to increase house building across all sectors.

In order to help bring about a step change in house building the NFA recommends the following solutions:

1. Unlock the potential to invest in council housing by removing the HRA borrowing caps and relying instead on prudential borrowing rules to enable councils to invest in new homes and pay the money back from their rental income.

2. Provide more bricks and mortar subsidies for social housing through grant rather than relying on more and more revenue subsidies through housing benefit.

3. Allow ALMOs access to grant funding on the same basis as other Registered Providers in the value for money assessment for HCA grant funding.

4. Consider the longer-term case for a planned and transparent move to adopt internationally recognised rules to measure government borrowing, to bring Britain in line with our competitors which exclude housing investment debt.

Introduction

Arms' Length Management Organisations (ALMOs) were first established in 2002, managing council housing at arms' length from their parent local authorities. There are currently 47 ALMOs which manage over 650,000 council properties across 50 local authorities.

ALMOs have a track record of success in delivering and managing new homes to a high standard. To date they have delivered over 2,000 new homes as ALMO owned developments or on behalf of their parent local authority as new council homes. They are scheduled to deliver at least a further 4,000 homes on behalf of their parent local authorities over the next 5 years.

As ALMOs are primarily the delivery vehicle for their parent authorities to manage and maintain council houses and where possible build new homes, the NFA has focused its submission on the structural barriers which prevent ALMOs and councils building more homes. We will seek to answer the two questions overleaf posed by the Commission:

1. The Commission believes that the current structure of the Housing Revenue Account (HRA) system is overly bureaucratic and is hampering sound investment in social housing. What flexibilities through the HRA and in other areas could be granted to local authorities so they can build more homes?

2. What are the barriers to greater private investment, particularly long-term investment. How much investment must we attract and through what mechanisms? What part can institutional investment play?

<u>Question 1</u>

HRA Self-Financed Business Plans and Debt Caps

April 2012 saw the most significant change in a generation to the way council housing is financed. With the end of the unfair and unpopular housing subsidy system, councils were freed to take a long-term view of their housing and manage it for the benefit of local residents in a more business-like, accountable and cost-effective way. However, the Government decided to set a debt cap for each local authority based upon its assumptions about the need to spend on management and maintenance over the next 30 years. Therefore the amount of borrowing available to each council varies enormously across the country and does not allow sufficient headroom for a significant amount of new build.

In 2012 the NFA supported ARCH, CWAG, the LGA and HouseMark to commission an assessment of the impact of self-financing on council rent decisions and spending plans. The assessment showed clearly that councils had seized their opportunity, raised their ambitions and begun a range of new initiatives made possible by the new finance system. Most had stepped up plans to invest in their housing, and many were planning to build new homes, often for the first time in many years. A 2013 NFA members' survey indicated that even more councils were planning to start building in the HRA with 94% of Councils with ALMOs planning to build new homes in 2014. However it is also clear that councils could afford to do more if arbitrary restrictions on council borrowing were relaxed or removed.

The research also showed that the availability of headroom varies enormously across the country: 28 authorities are already at their cap, another 28 only have between £1-5million that they are allowed to borrow, 32 have between £5-10million, 53 have £10-30million and just 28 have over £30million to invest in their stock over the next 30 years.

The headroom is intended to be used for all types of investment required in the council housing stock over the next 30 years. The vast majority of councils with large amounts of headroom are inner city authorities which also have significant outstanding decent homes programmes and large scale regeneration work to complete which will absorb a great proportion of that available investment leaving little left for additional affordable homes.

Many councils and ALMOs who are able and willing to build more new affordable homes are restricted by their debt caps and lifting them would allow them to develop locally appropriate and affordable plans based upon their council housing business.

New Build
From a standing start ALMOs have been enthusiastic and developed innovative approaches to housing delivery to make better use of local authority land and deliver high quality homes of the right type and size in their local areas.

ALMOs are keen to continue to use their expertise and develop affordable homes and believe that they add particular value to local areas through their development programmes, as they are generally tied to regeneration efforts or to redesigning areas on existing council estates which are disused and attract anti-social behaviour.

Recent ALMO developments have often been built on land that no other developer was interested in, land that was deemed to have little or no value and to be a cost to the local authority in maintaining and managing it. ALMOs have offered local authorities an option to develop that means the council can retain control over the land and the asset as well as ensuring that local housing management is not fragmented. ALMOs have also shown that they can deliver good value for money, often at a lower grant rate than housing associations in their area and ensure a quick development time due to their knowledge of the local community needs, expertise in resident engagement and understanding of the planning system.

Indeed we believe that much of the potential output is **only achievable by councils and ALMOs themselves**. Much of the land for new building by councils and ALMOs will be associated with existing estates, including replacement of unpopular or obsolete stock, using garage and commercial sites or unlocking 'backland' or garden land that is little used. Councils and ALMOs are best-placed to assemble such sites and work in liaison with existing residents of estates affected by new development.

Let's Get Building
In 2012 the NFA published a report called "Let's Get Building" and recently followed it up with a report called "Treating Council Housing Fairly" (copies of which are enclosed for reference). Let's Get Building explored how local authorities and ALMOs could make a much bigger contribution to building new homes and stimulating local economies, and explains how this could be done within prudential borrowing rules. It argues that councils and ALMOs should be allowed to make the most of their assets and future rental income to invest £7bn now to build 60,000 new homes over the next five years. A summary of the key points is made below:

- The cap on borrowing at the initial level of redistributed debt goes against the spirit of self-financing and does not fit with a proper business plan model where there will be peaks and troughs of investment need.

- Council housing has very low average debt levels, at just over £17,000 per house there is significant untapped borrowing potential based on future rental income that could be utilised now to help boost the economy.

- Given the scale of both housing and economic need, it makes sense to use the capacity of councils and ALMOs to build homes in addition to using the capacity of Housing Associations and private developers.

- The Prudential Code, the limits on rent increases and the HRA ring fence are all sufficient to ensure that local authorities do not increase borrowing at unsustainable levels.

- However if government feels an additional control is necessary at this time then the debt caps could be lifted either across the board or linked to an HCA bidding round for new developments.

Public borrowing rules need not limit council housing borrowing
The report "Treating Council Housing fairly" explains in more detail how changed borrowing rules could help build more homes and the key points are summarised below:

Currently councils have 'headroom' to borrow an additional £2.8bn to invest in housing. But without the caps and if they were encouraged to invest, their maximum potential might be £7bn over five years, building up to 12,000 extra homes per year.

- Additional local authority borrowing would add to total public sector debt levels under current fiscal rules; but the marginal increase in borrowing would be justified by the economic benefits and by the benefits of providing affordable homes.

- The UK's definition of what constitutes public spending and borrowing differs from the international one used by other EU countries and bodies such as the IMF, the OECD and credit rating agencies. Both include all national and local government spending, but whereas the UK's PSNBR (Public Sector Net Borrowing Requirement) and PSND (Public Sector Net Debt) include all spending by public corporations, which includes council housing services, the international definition does not.

- Any change to allow more freedom to borrow for council housing investment would therefore simply bring the UK into line with international rules.

- The government is providing guarantees for house builders which will produce a contingent liability in the event of default. However, if the government allowed more building by councils it would carry less risk to government and provide a more direct economic stimulus.

- Slightly more than half of social housing is run by housing associations, the rest by local authorities. Of these, some 47 have contracted out their housing management to an ALMO. These bodies are affected in different ways by the rules:
    - **Housing associations** are classified as non-profit private corporations.
    - All **ALMOs** are individually classed as public corporations.
    - **Directly managed council housing** services are known as 'quasi corporations' and are part of the public corporate sector.

- The effect of the rules is that while housing associations' own expenditure and borrowing does not count against government debt, similar expenditure by local authorities does count against PSND. So, while for housing associations only the grant they receive from the HCA is subject to the government's fiscal rules, for councils both any grant they receive and their borrowing are subject to those rules, even though for both types of body the costs of the borrowing are met from rents.

- England's 'council housing' model is unusual in being managed directly by local authorities whereas what is more common in the EU is for management or ownership being in the hands of a municipally owned company. Such companies enjoy the same borrowing freedoms as housing associations.

- This means not only that council majority-owned bodies can, in effect, build alongside housing associations (or their equivalent in each country), but that they can also take advantage of the cheaper borrowing available to them because they are backed by local government. While in England councils or council-owned companies could also borrow cheaply from private lenders, this advantage is negated by any new borrowing being restricted because it counts towards public sector debt.

- While market opinion suggests caution would be needed in making any rule change over the short term, the government could plan such a change in a transparent way, over a suitable time period, which would bring the UK into line with its competitors across Europe.

Treasury Concerns
<u>Need to reflect true public sector liabilities</u> - The Treasury argues that the wide 'public sector' definition of borrowing is the right one because it captures bodies whose finances would have to be underwritten by the state in the event of failure. There is however little or no evidence of public corporations getting into serious difficulty in recent times. On the other hand, the examples of private firms having to be rescued by the state are plentiful. Council housing has transparent accounts, managed by their parent local authorities: the scope for unpleasant surprises is therefore much more limited. Furthermore, in the comparable housing association sector, the limited cases of financial difficulty have been resolved *within the sector*, without recourse to public funds. HCA regulation could be extended to councils and their ALMOs to provide further re-assurance to the government that the self-financed business plans are prudent and the risks were being managed properly.

<u>Transparency</u> – As the PSND, is all-embracing, it is argued that it gives a fuller and more transparent picture of public sector liabilities. But the financial flows of the public corporate sector are regularly published in the Treasury's Public Expenditure Statistical Analysis (PESA), so transparency itself should not be an issue. Public corporations are also subject to EU competition law and to procurement rules to ensure open competition for any contracting they do. Councils are already subject to statutory guidance and to the Chartered Institute of Public Finance and Accountancy treasury management code.

<u>Unfair advantage</u> - The argument is that public corporations can borrow more cheaply and can therefore 'crowd out' private competition. This however is what is already happening with foreign companies (designated as public corporations in their own countries) operating in the UK transport and energy sectors. Moreover, the private sector has not been able to increase supply significantly in recent years and Housing Associations are limited in terms of grant levels and leverage within the sector. ALMOs and councils are not seeking to crowd out private sector

or housing association development but to supplement it at a local level to help solve the housing crisis.

Whilst the NFA remains acutely conscious of concerns not to see an increase in public sector borrowing, we believe it is odd that the UK is placing itself in an artificial straight jacket by adopting accounting rules for housing debt that are different from other countries and economic bodies and which are holding back the housing growth the country desperately needs.

A Ladder of Options

An alternative way to approach the removal of the HRA debt debts caps is to look at a ladder of options moving from the controlled, small scale and possibly complex, bidding round announced by the Chancellor in the Autumn statement to a general lifting of the debt caps to a new set level to make an additional allowance for new build for every council as was originally planned for in the self- financing deal. Alternatively the government could set a higher, index linked debt cap that increased over time to reflect inflation and then move to fully removing them and relying instead on the Prudential Code to ensure that any new borrowing was affordable and sustainable. We believe the way in which the government sets its targets for national debt need to be changed and would like to see a managed move from the use of the PSND to the GGGD but if the government still felt it was necessary they could create a new sub-set of the public accounts for council housing just as Treasury have done for RBS and Lloyds/TSB so that it can be recognised as the self-financing and socially useful service that it is.

The Prudential Code

If the caps were removed entirely and councils were able instead to use the Prudential Code to regulate borrowing there may need to be some new housing indicators developed to reflect the self-financing world in which the HRA now operates. For example, interest cover, debt/stock, operating surplus/turnover, Debt/EUVSH, Debt/OMV, Net income/EUVSH. The HCA could conceivably have a role in assessing and regulating the financial viability of HRA business plans if the debt cap no longer existed as it does with Housing Associations.

The system has demonstrably worked since 2004 as local authorities have sensibly managed borrowing and debt levels. We believe the system can be harnessed for effective use by the self-financing HRA, just as it has been working successfully for local authority financial management for some time now.

<u>Question 2</u>

Barriers to greater private sector investment in ALMO and Council Housing

The barriers to greater private sector investment in new council housing partly stem from the issues around the debt cap that are outlined above. If the debt cap were removed and councils were allowed to make investment decisions on a business basis the decision then as to whether to borrow from the private sector, work with institutional investors or borrow from the PWLB is a treasury management decision based on the costs and risks of each scheme.

However, if in the longer term the government agreed to change the way in which it accounts for council housing investment, recognising that council housing is a trading activity and that its borrowing need no longer count towards the main measure of general government debt the option to go to the private sector for long term investment could be more attractive as it would be off the government’s balance sheet.

There has been a lot of interest recently from pension funds and other institutional investors in ALMO new build (which has the advantage of being in the General Fund where Prudential Borrowing Code applies rather than in the HRA) but little has come to fruition as yet. Some of the reasons behind the lack of signed deals in this area are the levels of return that investors are looking for, the amount of risk that the ALMO and therefore the Council, is asked to take on and the complexity of some of the deals on offer. These have often made the deals too expensive and risky for ALMOs and Councils to take on.

We are aware that the Greater Manchester Pension Fund is investing in new housing development on council owned sites in Manchester but the ALMO is not directly involved in that scheme. Another of our members is looking at a deal with a pension fund for an Extra Care scheme. It would be a long lease for management and maintenance with guarantees for the pension fund on a certain return over that period. It would then be available to the ALMO for a peppercorn at the end of the lease period. The ALMO is looking at the risks of letting and collecting the rent on that particular site and seeing if it could work. There is some concern over the future funding of extra care which makes this scheme a bit more risky.

Risks

As a sector that is often subject to political intervention from all types of government, that is responsible for housing some of the most vulnerable members of society and is reliant on on-going state support in terms of many its tenants receiving housing benefit, supporting people funding or local authority care packages there is a lot of risk that it cannot manage itself and a certain level of tolerance has to be built in to any schemes being financed over the long term.

One of the biggest areas of risk at the moment in social housing is around collecting the rent whilst the welfare reform agenda is carried out and the roll-out of Universal Credit is around the corner. These changes are already adversely impacting on the ability of social housing landlords in some areas to collect the rent in the short to medium term and driving up the costs of collecting that rent. A recent joint NFA/ARCH/CWAG survey into the impacts of welfare reform showed that overall the number of households in arrears rose by 21% on average across the country between March 2013 and the end of June 2013 and the amount of rent arrears increased 16% on average between March 2013 and the end of June 2013. This is obviously a concern to both landlords and any potential investor in the sector and may jeopardise any developments of social housing funded by institutional investors in the near future.

For further information, please contact Chloe Fletcher at chloe.fletcher@almos.org.uk or on 07515 050207

Enclosed for further information:

Let's Get Building
Let's Get Building – The View from the City (2012) (report by Capital Economics)
Treating Council Housing Fairly
NFA 2015 Election Manifesto