A proposal from ARCH, CIH, CIPFA and NFA to contribute towards the government's house building target

Executive summary

Four national organisations, ARCH, CIH, CIPFA and NFA, have identified a set of high-level housing policy requests that would allow local authorities to invest in building more new homes and support the government in its delivery of their objective of one million new homes by 2020.

The paper shows that with changes to specific areas of housing policy the sector has the potential to substantially raise its output without extra government grant. It does this by exemplifying the potential extra output of several hundred homes each, from three potential pilot local authorities.

The main high level policy areas in which changes are proposed are:

- flexibilities in borrowing caps
- greater stability and certainty of rental income
- better use of receipts following right to buy.

Three pilot proposals from a range of different sizes of LA show how this might done. They are: Newark and Sherwood, Sheffield and Stoke-on-Trent.

What is in this paper

The paper is in two parts. The first sets out the general case for changes to rules affecting council housing finance that are holding back new development. The second sets out the three short pilot proposals. Each consists of a short narrative followed by a specific proposal, following the same format in each case.

Recommendations to government

The four organisations urge the government to:

- consider the proposals and examples in this paper, and
- launch a pilot scheme to enable councils to make bids to build target quantities of new homes that would not otherwise be built, based on specific agreements as to which national rules might be modified.

December 2016

A proposal to contribute towards achieving the government's house building target

Background: why reform is needed

Housing supply is key to economic growth and a crucial factor of public concern as the country enters a period of economic change. Progress in improving housing supply is of course being made, but as the Secretary of State has recently acknowledged, it is 'nowhere near good enough'. Within the industry, there is recognition (including by the private sector) that the government's target will only be achieved if all actors use their full capacity – which means local authorities contributing towards housebuilding alongside developers and housing associations.

An approach that allows local authorities the opportunity to use their resources with greater flexibility would improve current housing prospects by providing additional homes at below-market rents as well as for market rent and sale. . They can help provide what the Secretary of State calls 'a housing market that works for everyone', not only those readily able to take advantage of home ownership. Evidence shows that social rented homes can in fact be a stepping-stone to home ownership, and help additional housing to be absorbed into the local market by offering a mix of products and prices. Also, by providing homes at affordable rents they help ensure that work pays and that claims on housing benefit are reduced.

Our recommendations to government are focused on flexible investment, sustainable rent policies and effective replacement of assets. These three key pillars of a modified housing policy are essential if the government's goal of one million new homes is to be reached. By strengthening each of these pillars the capacity to deliver on that goal becomes more achievable.

The CIH and CIPFA report Investing in social housing highlights how recent changes in policy have had ripple effects with impacts far beyond their original reach. The change in policy towards rent is the prime example: the 1% annual reduction over four years will take £2.6 billion off local authority budgets. Whilst acknowledging that some councils are still able to invest, the overall effect of recent policy changes is a substantial fall in the sector's house-building capacity.

A sequence of changes in agreed rental and other policies, on which local authorities based their financial plans after the government's self-financing settlement in 2012, have led to increasing concern for the future. Forward-looking local authorities that produced business plans based on known factors and the financial sustainability of their housing service have had these plans undermined by these changes.

Where is reform needed?

Investment flexibilities

It is important that local authorities are able to produce a strong economic argument for investment funding and demonstrate the ability to repay that investment. Our research shows that the combination of policy changes over the last four years has meant that the capacity to build new homes has dropped from an original potential level of 550,000 over thirty years (if all investment capacity were devoted to new build) to just 45,000 units over the same period.

A detailed case for HRA-based investment by councils has been made elsewhere, notably in the NFA-led joint report Let's Get Building and in the NFA-SHOUT report by Capital Economics, Building New Social Rent Homes. They both make the economic case in terms of benefits to the local economy and in savings in housing benefit because of lower rents.

One of the most important reservations about the original self-financing settlement was that it involved new borrowing caps on local authorities, which do not apply in any other area of their operations. While the issues about sustainable rental income have overtaken borrowing caps as a main area of concern for councils (see below), it remains the case that there are some authorities with capacity to invest who are held back by artificially low caps, often well below what would be compatible with prudential borrowing rules. More flexibility is needed while the overall level of borrowing could continue to be monitored, as now, by the Treasury and the OBR.

One response to this has, from time to time, been the suggestion that caps could be shared between authorities in a region. While there is no objection to this, and it is a sensible reform in the context of combined authorities, it does not in itself address the problem of caps that are too low. This is because it assumes significant 'spare' borrowing capacity in other councils which may not exist or which they may well be unwilling to 'share' as there is no incentive to do so.

Many councils are establishing housing companies to maximise their options. This approach highlights the anomalies of the HRA cap and is a solution that may lead to homes being developed at higher, rather than lower, rent levels.

Sustainable rent polices

In July 2015, the Summer Budget announced that rents would be reduced by 1% a year for four years resulting in a 12% reduction in average rents by 2020/21. The LGA forecast a cumulative loss of £2.6bn to housing revenue accounts, and commented: 'The cost to councils will rise from £234m in year one, to £508m in year two, £795m in year three, and over £1bn by 2019/20. By that point the annual funding gap will represent 60% of local government's total housing maintenance budget.'

Local authorities had made assumptions about future HRA income based on previous government policies and firm promises that they would not be significantly changed. These included the expectation that guideline rents would converge with formula rents in 2015/16 and that rent increases would be just above inflation year-on-year after 2015/16. Councils were assured that future rent decisions would be left under local control.

The undermining of rental income without any compensation has placed an unacceptable pressure on income streams. Financially sustainable investment is stifled if income streams are not stable and predictable. Local authorities need to have confidence in future income streams if they are to make substantial investment decisions.

Addressing the reduction in the asset base

Assets are being sold more quickly than anticipated and this impacts on a council's ability to raise investments. The reinvigorated right to buy has resulted in an increase in sales of council homes, which are not being replaced. CIH estimates that the net loss of LA rented stock from sales and demolitions over the four years from 2012 is approximately 70,000 units, despite increased new build over that period. The recent decision not to go ahead with pay-to-stay has also been welcomed as it could have led to a further rise in council house sales.

Fortunately, the government has recognised that the enforced sales of higher-value stock would have had a further big effect on LA assets and has delayed this policy change until after 2017/18. However, the continuing threat of high value sales is still inhibiting longer-term investment, especially in those local authorities likely to be most affected.

Councils want to slow down the losses from their asset base by a reconsideration of the rules that govern replacement. Good asset management should influence decision-making. Councils know that there is a need to review and sell assets, they are also aware that right to buy can have a positive outcome. However these decisions must be made in consideration of all the facts at local level.

A 2015 study by CIH and the LGA showed the extent of the problems which LAs have in replacing homes sold through right to buy. The report called for a range of flexibilities to enable more effective replacement, including the ability to apply more than 30% of each receipt towards replacement costs, and flexibility in the requirement for receipts to be reused within three years. Local authorities would like the government to see right to buy receipts primarily as a resource for new house building, and only secondarily as a source of income to the Exchequer, given the potential capacity which councils have – with better access to their capital receipts – to build new ones.

The time is right

The local authority sector believes that without ensuring that they play a leading role in the delivery of housing solutions there will continue to be a housing shortage. The Chartered Institute of Housing and the Local Government Association have both provided research that illustrates the potential of the sector to increase supply if conditions are right.

The appointment of Housing and Planning Minister Gavin Barwell signalled a perceptible change in government policy towards recognising the importance of affordable rented housing. Rather than home ownership being seen as a viable solution for all, there is now recognition that affordable, sub-market renting is essential to provide 'a housing market that works for everyone'.

In a recent speech Mr Barwell said the government remained committed to helping people on to the housing ladder, but acknowledged:

> "We need more homes for sale, we need more homes for private rent, and we need more sub-market homes for rent."

This has been followed by an extra £5 billion of housing investment in the Autumn Statement, welcomed by all those in the housing sector.

The local authority sector wants to build on this and make a fuller contribution to government aims by making greater use of its own resources, in the ways described in this report. ARCH, CIH, CIPFA and NFA are encouraged by the significant changes in the government's approach. However, as organisations which support the delivery of housing solutions particularly for those on lower incomes, we are concerned by the current limitations and inflexibilities will continue to severely limit the contribution local authorities can make. Hence we make the case for modifying or removing some of the most important obstacles.

Next Steps

This paper presents an argued case for flexibilities in government policy, to be applied at individual local authority level, which has the potential to unleash resources that otherwise will go unused. The intention is to put forward a series of bids that, if approved, would enable those local authorities to build more homes, make better use of the resources they have and provide local communities with greater choice.

The rest of this paper is devoted to the initial bids from three local authorities. Each has the same format – a short narrative setting the context and a bid in tabulated form setting out what is planned, what it could achieve and what changes are required to enable this to happen. The different sizes of LA involved show how the proposal could potentially generate extra output across a wide range of authorities.

ARCH, CIH, CIPFA and NFA wish to engage constructively with government to ensure the proposals in this report receive full consideration. Such an initial discussion could pave the way for consideration of the individual local authority bids to form a pilot scheme, which could potentially then lead to a wider scheme to encourage bids along these lines at national level.

Participating local authorities and ALMOs with pilot proposals:

Newark and Sherwood District Council

Sheffield City Council

Stoke-on-Trent Council

An additional seven LAs/ALMOs have expressed an initial interest in submitting bids and the real potential is believed to be much greater than this.

Individual local authority bid: Newark and Sherwood District Council

Context:

The promotion of housing growth and the delivery of additional affordable housing continue to be a strategic priority for this council, with the need to develop a mixed provision of affordable homes. The council has made significant progress with regard to planning for new housing; it adopted a Core Strategy in 2011 which promotes strategic urban extensions around Newark Urban Area and sustainable growth in the other main towns and villages. In 2013 the council adopted its Allocations & Development Management DPD, allocating around 60 sites for housing employment and retail development. The council is currently reviewing its planning policies to ensure that sites remain deliverable.

The council holds a robust housing needs evidence base, with the most recent district wide Housing Market and Needs Assessment (2014) identifying an affordable housing shortfall for the next 5 years of 221 homes per annum across the district. To address the evidenced housing need over the last five years the council in partnership with its housing management company, Newark and Sherwood Homes, has directly developed 111 new council homes. The council has also proactively intervened to support wider housing delivery in the district though the acquisition of Section 106 affordable housing units.
A 60-apartment extra care scheme is now under development, being delivered by the council in partnership with its housing management company, Nottinghamshire County Council and the HCA.

As part of the council's range of approaches to secure the delivery of additional affordable housing it has also supported housing associations through housing grants and release of council housing land. During the past eleven years over 900 additional affordable homes have been provided within the district.

Set against the council's own established track record of developing new affordable housing, it has recently approved a five-year programme, commencing early 2017, to deliver an indicative 335 units across council-owned infill sites, enabling the council to make best use of its land assets. The council is delivering an ambitious housing growth programme, fully committing and utilising all its available resources and assets prudently.

Some relatively minor adjustments in government policy this will give the council the ability to accelerate its current development programme and enable additional new homes to be delivered by 2021. The proposed changes are:

1. The HRA borrowing cap to be increased by £18M from 2017/18.
2. Annual rent increases to be confirmed as CPI+1%, for a period of 30 years and subject to a minimum of 2% in any particular year.
3. Existing land ownership to be invested and disregarded as subsidy for HCA grant assessment.
4. A facility to combine RTB receipts and HCA grants to a maximum (say) of 50% of total scheme costs.

Summary of proposal:

Current HRA development programme			
Current new development funded through HRA (total units and general summary)	**How funded (total cost and breakdown of sources, inc. use of grant if any)**	**Property mix (new build/acquisitions, sale/rent, whether social rent, etc.**	**Delivery timescales (not extending beyond 2020/21)**
Gladstone House Extra care scheme 60 units	Total Scheme Cost (TSC) £8,000,000 £1.5m HCA grant £3.2m Notts. County Council £2.7m HRA £0.6m N&S Homes funded	New build – Affordable Rent	Complete January 2018
Belle Vue - Market sale 21 units	TSC £2.55m N&S Homes – Company funded	New Build – Affordable Rent and Market Sale	Complete Aug 2018
Infill sites 335 units – 5 year programme	TSC £33.5m HRA funded	New Build – Affordable rent year 1 combination of affordable rent and equity options being considered from year 2.	Commence Apr 2017 – Complete Mar 2022 Delivery profile to HRA current maximum capacity as follows 70 units 2017/18 82 units 2018/19 83 units 2019/20 50 units 2020/21 50 units 2021/22
Section 106 Acquisitions Farnsfield - 16 units; Ollerton - 8 units.	Total Section 106 acquisition costs for 24 units £1,075m – HRA funded	Property Acquisition – Affordable rent	Complete between Jun 16 and July 2018
Summary of bid to achieve additional programme			
Additional development planned if bid succeeds (total units and property mix)	**Government 'ask' (rents, RTB receipts, borrowing caps, grant, etc.)**	**How funded (total cost and breakdown of sources, inc. use of grant if any)**	**Preparations already in hand and timescales for delivery (up to 2020/21)**
Infill Sites Programme acceleration 335	Rent increase CPI + 1% from April 2017 and for a	HRA £33.5M	335 New Build 2017/18 - 70 2018/19 - 135

units in 3 years.	period of 30 years and subject to a minimum of 2% in any particular year. Generates income in the first year to compound for additional delivery. Increase debt cap by £18M from 2017 allows additional capacity to bring forward the build programme.		2019/20 - 130
Bridge ward Regeneration Scheme 300 properties for rent and market sale	DCLG Estate Regeneration Programme	HRA £10m receipts, HCA, Private investment (joint venture), DCLG Estate Regeneration Programme	228 New build, 72 Re-provision 2018/19 - 90 market sale and affordable rent 2019/20 – 90 market sale and Affordable rent 2020/21 – 120 Market sale and affordable rent
Targeted site and s106 acquisition. 40 properties	Rent increase and additional borrowing as above. Rent from additional units already built through accelerated infill programme	HRA £2m	40 Acquired properties 17/18 - 10 18/19 - 15 19/20 - 15
Extra Care Scheme, west of the district 30 properties	Rent increase and additional borrowing as above. Rent from additional units already built through accelerated infill programme.	HRA £2m, Potential HCA, Nottinghamshire County Council	New build extra care. 2020/21- 30 affordable rent units

Individual local authority bid: Sheffield City Council

Context:

The commitment to optimising the number of new/replacement council homes continues to be a high priority.

This year the stock increase programme continues to work to the target of 1,000 new/replacement homes, with a higher proportion of new build units in order to provide the mix of properties we want to achieve. It is expected that the overall cost of the programme will remain the same.

Newly acquired properties as part of the programme will continue to be let at an Affordable Rent where allowed by government in line with last year's decision responding to pressures on the programme due to the 1% rent reduction.

The programme has been balanced so that the use of RTB receipts is maximised to match our current RTB forecasts. Any additional units would require either additional RTB receipts or – as indicated below – an agreement to utilise a specific sum as 30% external funding.

As the table below demonstrates, we do feel that there is the potential to increase new building if suitable financial flexibilities are put into place.

Summary of proposal:

Current HRA development programme			
Current new development funded through HRA (total units and general summary)	**How funded (total cost and breakdown of sources, inc. use of grant if any)**	**Property mix (new build/acquisitions, sale/rent, whether social rent, etc.**	**Delivery timescales (not extending beyond 2020/21)**
1,000 units From 14/15 to 20/21	£100m total programme: £80m core resources, £1m HCA, £19m RTB Receipts	471 (47%) acquisitions, 529 (53%) New build. 31% Social Rent (includes majority of new build programme), 69% Affordable Rent.	**Acquisition**, **New Build** 14/15 and 15/16 (actual): **228 units**, **0 units** 16/17: **87**, **51** 17/18: **55**,**0** 18/19: **53**,**46** 19/20: **53**,**270** 20/21: **53**,**104**

Summary of bid to achieve additional programme			
Additional development planned if bid succeeds (total units and property mix)	**Government 'ask' (rents, RTB receipts, borrowing caps, grant, etc.)**	**How funded (total cost and breakdown of sources, inc. use of grant if any)**	**Preparations already in hand and timescales for delivery (up to 2020/21)**
750 additional general needs new build units*	Increase debt cap Remove restrictions on 1-4-1 agreements – or make them more flexible Protect any further new build from RTB Allow authority to retain some or all of the RTB Levy if used for new build	£90m total programme: £27m to be used as if RTB receipts £63m core resources (borrowing)	Substantial lead-in time required to prepare for delivery alongside 104 general needs properties in programme in 2020/21 at present.

*Figure as a result of preliminary modelling October 2016

Individual local authority bid: Stoke-on-Trent City Council

Context:

Stoke is a stock-owning council and faces enormous issues in meeting the rising demand or new or replacement, private market and affordable homes. There is a specific and urgent requirement to replace 212 redundant, sheltered flats and to deliver an additional 921 sheltered/supported homes by 2021.

Stoke has established a Local Housing Company, Fortior Homes, which has set an ambitious target of 350 market rent homes, in management by April 2019. Many of these homes are being generated by the work of our private sector housing supply team in progressing four Housing Zone initiatives and engaging with residential developers to generate investment.

The effect of recent policy changes, on rents, welfare benefits & HCA investment, is that housing associations are no longer active in developing affordable homes in the City. The council has therefore accepted the challenge and is proposing to undertake the required programme directly. To date, the council has worked up and submitted indicative HCA grant bids for 161 new, sheltered units on three sites in the council's ownership. All three sites will be converted to firm bids, with detailed planning consent and able to start on site during 2017.

This programme is a quantum leap from previous direct development activity but is constrained by financial capacity. Viable opportunities are not in short supply given Stoke's fortunate position with developable land in its ownership. With some relatively minor adjustments in government policy, Stoke can readily deliver an additional 570 new homes by 2021.

The required changes are:

- RTB receipts to be invested within five (rather than three) years of receipt, with the facility for councils to be able to forward commit, and take the risk on, RTB receipts up to two years in advance of receipt.
- Existing land ownership to be invested and disregarded as subsidy.
- A facility to combine RTB receipts and HCA grants/to a maximum (say) of 40% of total scheme cost (TSC).
- Rents, on new homes, to be 80% of market or 110% of target, whichever is the greater.
- Annual rent increases to be confirmed as CPI+1%, for a period of 30 years and subject to a minimum of 2% in any particular year.

Summary of proposal:

Current HRA development programme			
Current new development funded through HRA (total units and general summary)	**How funded (total cost and breakdown of sources, inc. use of grant if any)**	**Property mix (new build/acquisitions, sale/rent, whether social rent, etc.**	**Delivery timescales (not extending beyond 2020/21)**
QE2 Court, Fenton 57 units retirement living	TSC £ 8.15 m £5.06m HRA + £3.42m HCA grant	New build development for rent at LHA levels	SoS Q1, 17/18 PC Q3 18/19
Brookwood, Weston Coyney 74 units retirement living	TSC £25.5 m £3.23m HCA grant + £5.062 m HRA	New build development for rent at LHA levels	SoS Q1 19/20 PC Q3 20/21
Infill sites & bungalow acqs. 20 units pa 80 units total	TSC £10m £3m RTB receipts + £7m HRA	New build development for rent at LHA levels	20 units pa 80 units complete by end of Q4 20/21
Abbots House 12 units Supported housing for LD	TSC £ £1.76m £1.76m HRA	New build supported homes for learning disability – social rent	SoS Q2 18/19 PC Q4 18/18
Fenton centre 60 units retirement living + 20 PRS	TSC £8.5m £2.4m LHC £6.1m HRA	New build development. 1st phase of mixed tenure project	SoS Q1 18/19 PC (Phase 1) Q2 20/21
Homeless temporary accommodation 12 units	TSC £ 1.6m £576k RTB receipts + £1.024m HRA	New build, furnished temporary accommodation units	SoS Q3 18/19 PC Q3 19/20

Summary of bid to achieve additional programme			
Additional development planned if bid succeeds (total units and property mix)	**Government 'ask' (rents, RTB receipts, borrowing caps, grant, etc.)**	**How funded (total cost and breakdown of sources, inc. use of grant if any)**	**Preparations already in hand and timescales for delivery (up to 2020/21)**
120 units retirement living + 300 new bungalows + 150 rent to buy homes	RTB receipts to be used within 5 years (not 3) LAs to be able to forward commit RTB receipts To deliver rents at LHA levels, combine RTB receipts with HCA Grant to increase subsidy to (say) 40% of TSC LA land, at nil cost, to be disregarded as subsidy Rents at greater of 80% of market or 110% of target Rents increases at CPI+1% pa guaranteed for 30 years Minimum annual rent increase of 2%	Est TSC @ £145k per unit - £82,650,000 to deliver 570 new homes. **Funded Via:** RTB receipts (inc. forward committed) - £10 million HCA Grant - 120 units @ £45k - £5,400,000 300 units @ £35k - £10,500,000 150 units @ £30k - £4,500,000 Total -£20,400,000 Institutional investor - £30 million HRA - £22,250,000	Asset register – sites identified Asset management plan in progress to identify redundant stock for redevelopment by Dec 2016 Architects & surveyors appointed & progressing sites with capacity for over 400 homes (QE2 24 extra Brookwood 150 Fenton 160 Sneyd Green 29 Meir 74 Abbots 12 Est. Delivery 18/19 – 100 19/20 – 250 20/21 - 220