Association of Retained Council Housing

Submission to the Lyons Housing Review

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Introduction

1. The Association of Retained Council Housing (ARCH) represents councils which own and manage housing. We welcome the opportunity to contribute to this review. There are 167 councils in England owning nearly two million homes. In 45 of these the council housing stock is managed by ALMOs; the remainder, with over a million homes, manage housing directly. We have not attempted to address all the questions included in the Call for Evidence. Our submission focuses on the particular contribution councils with housing can make to increasing housing supply. It is drawn from work so far on a larger project to helo and support member councils to make the most of their opportunities to deliver housing growth, and we would be happy to provide additional information from this work as it proceeds[1].

2. The key points in our submission are:

3. *Given the consensus that our current development industry is not capable of delivering the homes we need, how can we bring about greater capacity, competition and diversity to ensure it can deliver the homes our country so badly needs?*

   The Review has been asked to produce a road map to deliver 200,000 new homes a year by the end of the next Parliament. This is a realistic approach given that it will take time for the housing industry to gear up to increase in output. However, we believe that housing growth cannot stop there; in the longer term it will be necessary to further increase supply to at least 250,000 new homes a year. Of these, around a third will need to be affordable homes for let at rents substantially below market levels.

4. Meeting this challenge involves increasing private sector output to around 165,000 homes a year, 60 per cent up on annual supply during the recession but less than 20 per cent above average annual output during the previous decade. But it means doubling the current supply of affordable housing, which is a challenge of a different order. We argue it can best be met by encouraging and enabling councils to build up to 30-40,000 homes a year, alongside expanded investment by housing associations.

5. *The current structure of the Housing Revenue Account 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?*

The key step needed to enable councils to build more homes is to remove the debt caps that currently limit HRA borrowing. Councils have the financial capacity to support an additional £20 – 25 billion in investment from planned rent income alone, without external subsidy. Within current borrowing limits, councils are planning to expand building to 4-5000 homes a year. Removing debt caps would provide the financial capacity to expand output to 17-20,000. Giving councils explicit powers to build for sale and market rent within the HRA would enable them to use the financial strength of the HRAs to spread the associated risks and cross subsidise additional social housing from surpluses earned.

6. As well as starting to build again in the HRA, councils are involved in a variety of arrangements for providing new housing outside the HRA, including local authority-controlled companies and partnerships of various types with private sector and housing association partners. These arrangements have an important role to play, but they are often legally complex and expensive to set up and manage. They have been designed to work round a legal and financial framework which no longer makes much sense. Particularly for councils which have not run large development programmes for many years, there is a need to evolve simple and reliable models, and direct council provision should be among them.

7. There is a strong argument for changing government borrowing rules to exclude HRA borrowing, along with that of other public corporations, from the controls imposed on general government borrowing, bringing the UK into line with international practice. This would allow councils to invest in housing up within prudential limits, but it may also imply that they should no longer rely on the Public Works Loans Board as heavily as they have done in the past. Municipal bonds are an alternative worth exploring, among others.

8. *Is the current planning gain system fit for purpose and what alternatives exist?*

In 2008, planning obligations in s106 agreements were worth almost £5 billion and contributed to the provision of 30,000 new homes. And there was little evidence of developer opposition to the principle. This clearly reflects the buoyancy of the housing market and the economy at that time, and it would be wrong to expect a similar contribution today. But as house prices accelerate and the economy picks up, it is reasonable to expect the development industry's contribution to reflect this. However, Community Infrastructure Levies, which are intended to largely replace s106 planning obligations, cannot be used to fund affordable housing, and there is little evidence to date that the New Homes Bonus has been effective in incentivising a significant release of land.

9. We would argue for both CIL and NHB to be reviewed. Either CIL should be widened in scope to include affordable housing, or it be made explicit that site specific planning obligations for affordable housing may be negotiated in addition to CIL. NHB was always a

poor substitute for long-overdue reform of the local government finance system to provide a more buoyant tax base that responds quickly and proportionately to growth in local population and prosperity.

10. These points are developed in more detail below.

The need for more new homes

11. The primary case for more investment in housing rests on evidence of growing housing need and unsatisfied demand. The chronic shortage of housing has also helped to drive up house prices and market rents across the country, putting home ownership out of reach for four fifths of newly forming households and, according to research by the Resolution Foundation, committing 1.3 million households on low and middle incomes to pay more than 35 per cent of their income on housing costs[2]. There is not only an overall need for more homes, but a particular urgency to increase the supply of affordable housing in general and specifically of social housing built or enabled by councils.[3]

Overall need for new homes

12. The government's housing strategy *Laying the Foundations* said that current household projections indicate a demand for 232,000 extra homes each year over the next twenty years. Respected forecaster Alan Holmans carried out an appraisal of housing need which took into account these projections, loss of stock and other factors. He concluded that an average output of 252,000 new homes is needed annually over the period to 2026, of which 169,000 should be market housing (both for sale and rent) and 83,000 should be social housing at sub-market rents.[4] A 2008 appraisal for the previous government suggested a minimum annual target of 231,000 with a possible need to build up to 297,000.[5]

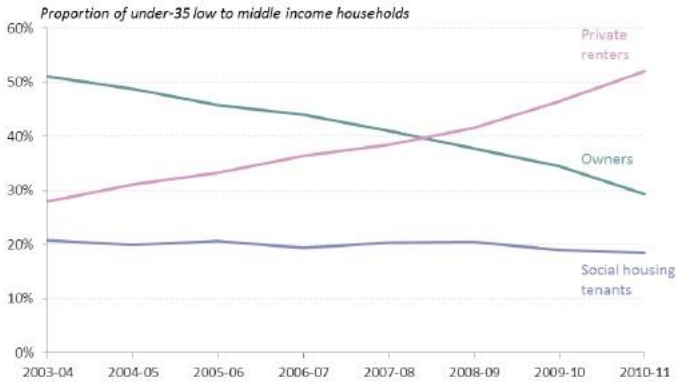
13. While the latest (2013) household projections show a slightly slower rate of growth than earlier ones, at 221,000 extra households per year until 2021,[6] 386,000 households actually formed in 2012/13.[7] This suggests that new need is arising that will require output well above 200,000 new units annually and probably at least as many as the 240,000 target set by the previous government in 2007.

14. However, there is also evidence of a growing backlog in unmet need. In part this is because of the extreme slow recovery in housing supply: in the four years since 2009 housebuilding output has been little more than two-thirds of what it was in the previous four years.

15. As would be expected, the needs of new households arise primarily from young adults. Typically four-fifths of new households are people under 35 years old. The *English Housing Survey* shows the importance of rented homes for such young households. For all but 19 per cent, their first home is rented: one in six new renters are social tenants and the remainder are private tenants. The numbers of young households in private renting continue to grow, now for the first time in recent history exceeding half of all those under 35: some 2m households. The numbers of families with children who are in private renting has doubled in the last decade.

Need for more homes for those on low or moderate incomes

16. As housing demand grows and costs increase, many have no choice but to pay excessive housing costs. The Resolution Foundation found that 1.3m households on low or middle incomes pay more than 35 per cent of their income in housing costs (a well-accepted threshold of affordability). Looked at another way, one-third of Britain is effectively off-limits to such families because of the levels of private rents.[8] The Resolution Foundation showed that the tenure choices of young households who are on low/middle incomes shows a dramatic shift (see chart). Also, a forward-looking study in 2012 suggested that 1.5m *more* young people (aged 18-30) will live in the private rented sector over the period to 2020, because of continuing constraints on access to homeownership and social housing.[9]



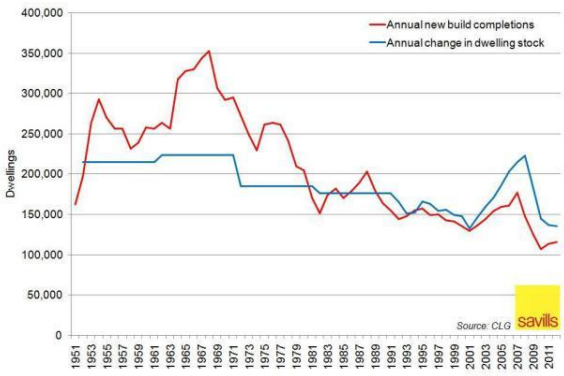
Notes: Under-35 low to middle income households are those in which the head of household is under 35 years old

Source: Resolution Foundation analysis of DWP, Family Resources Survey 2010/11(and earlier)

17. The problems caused for low/moderate earners in the private rented sector are corroborated by the rapidly growing numbers relying on housing benefit: a quarter of private tenants in 2012/13 compared with 19 per cent in 2008/09.[10] Partly as a consequence of high rents, a 2010 study by Alison Wallace[11] showed significant numbers of private renters who would prefer to be social housing tenants, including:
    1. 37-44 per cent of private renters with incomes below £29,999 per year
    2. over half of those aged 45–64
    3. over half of couples under 55 with children.

Housing supply

18. Total new housing supply crashed after the credit crunch. For the last four years, average annual completions in England have been only 111,000 compared with an average of 152,000 in the previous four years. The chart below puts recent supply into historical perspective, by illustrating the net increase in the stock after demolitions and new conversions are taken into account.



19. Within total output, the key component in addressing needs of those on low/middle incomes is the numbers of affordable units (including low-cost homeownership). As noted above, Alan Holmans projects a need for 83,000 new units per year. The government has a target output of 170,000 over the four years to 2015 (or about 42,000 per year). In 2012/13, the target was met: 42,830 homes were supplied at below market prices, but this was barely more than half of the Holmans projection and 26 per cent below 2011/12 (itself a slight fall on 2010/11).[12]

Offering better options for market renting and low-cost homeownership

20. The government's Help to Buy (HtB) scheme offers significant help to a segment of potential buyers who could not meet the deposit requirements for a mortgage. Even so, HtB will not assist large numbers who cannot afford the repayment costs of purchasing either with a 95 per cent mortgage or a 20 per cent equity loan. In most areas of the country, homeownership is still unaffordable to 5.6 million low/medium income households.[13] Unfortunately, given the very tight constraints on social sector supply and the competition for lettings already noted, a large proportion of these households have no realistic expectation of a social letting, meaning that private renting is their only option to avoid sharing or staying in the parents' home, albeit that rent levels mean their ability to pay will either be tightly stretched or they will be forced to accept poor quality lettings, or both.

21. This indicates the need for a range of housing provision for low/middle income households, beginning with a much bigger component of social rent but also including low-cost homeownership and market or below-market rented housing for those unlikely to get a social letting even if supply increases.

22. Apart from rent levels, the problem with the already growing reliance on private renting is that most of the increase in tenancies has been at the expense of other tenures, rather than through new build. Obviously, this is just switching stock, not adding to supply, and further reduces options in the other tenures. The government has acted to stimulate new build in the rented sector following the Montague report. Its Build to Rent scheme invests in new, market rent properties: the first round is expected to lead to 8-10,000 new units and a

second round is now underway.[14] A separate private rented sector guarantee scheme, worth up to £3.5bn, is also intended to stimulate investment in building new market rent property.

23. If such schemes can be set up so as to make limited call on the public finances, they are worthy of further consideration and possible expansion. However, any expansion of such schemes would need to address key issues:

- do they genuinely deliver an increase in supply?

1. do they focus largely or solely on the top quartile rental market in London, which is the most profitable segment of the market but does little or nothing to assist those on more modest incomes?
2. can any scheme be configured specifically to produce attractive options to those on middle incomes who are unable to access the other two main tenures?
3. It would also need to be *additional to* measures to provide affordable rented homes.

24. There is also a case for a larger low-cost homeownership (LCHO) programme to provide another option for those not helped by HtB. The Resolution Foundation has recently shown what the elements might be.[15] It calls for shared ownership to become the 'mainstream fourth tenure' through the creation of a new equity fund to encourage an increase in new homes built, modelled on the Build to Rent fund. It recommends bringing private capital from pension funds and other institutional investors into shared ownership by opening up the private rented guarantee scheme to LCHO.

The scale of the challenge

25. Achieving 160,000 homes for sale or market rent and 83,000 homes for social rent would mean increasing the output of private housing by around 60 per cent compared with average output for the last four years but only 20 per cent more than the average for the four years before that. However, it means doubling the output of social housing. 83,000 social homes a year has not been achieved since councils were stopped from building in the 1980s. Councils as well as housing associations should be encouraged to build more. The combined efforts of both sectors are needed.

26. Since the introduction of HRA self-financing in April 2012, councils have had the opportunity to build again on a limited scale and have been grappling with the challenge of developing the capacity to do so. Most larger urban councils have been used to running large scale regeneration and investment programmes, which are now being refocused on the provision of extra homes. Some smaller councils are rebuilding the capacity to build more or less from scratch. Access to advice and support and the opportunity to work together on shared challenges is essential to enable all councils to make the most of their opportunities.

Housing delivery options

27. Councils have a responsibility to assess housing needs in their areas and develop and implement strategies to ensure they are met. This responsibility covers all types of housing need and therefore the supply of homes for sale and market rent as much as low cost home ownership options and social housing whether at "affordable" or social rent. To meet theser strategic objectives, councils have a variety of delivery options available. These fall into four main types:

- Use of planning powers to encourage new development, including use of s106 agreements or Community Infrastructure Levies to secure provision of affordable housing and necessary infrastructure;
- Partnership arrangements of various types between councils, developers, housing associations and others, to which the council typically supplies land and the other partners supply finance and undertake development;
- Local authority-controlled companies which acquire or develop land for housing outside the Housing Revenue Account (HRA);
- Direct provision of new council housing through the HRA.

Each of these is considered in turn.

Use of planning powers

28. When planning permission is granted for housing there is normally a substantial increase in the value of the land concerned. The development control system allows councils to claim some of this additional value and ensure it is used for the benefit of the local community, either through the provision of community infrastructure or affordable housing. Since 1990 local planning authorities (which are also local housing authorities) have had powers to require contributions from developers (so-called section 106 agreements) both in the form of affordable housing and through financial contributions. In theory, planning obligations are there to make acceptable what would otherwise be unacceptable development. Those that provide affordable housing have become known as Affordable Housing Requirements (AHRs).

29. The coalition has been critical of AHRs, particularly in a depressed market, aiming to restrict their scope and provide other incentives for development. The Community Infrastructure Levy (CIL) is seen as largely replacing s106 agreements but it is only slowly being introduced. It will allow councils to raise funds for a wide range of infrastructure costs linked to development but not for affordable housing. The New Homes Bonus (NHB) is also another

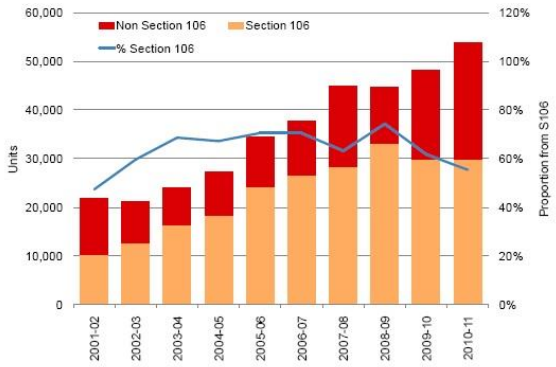
incentive alongside both CIL and s106.

30. Given its continuing importance in delivering affordable housing, the future of planning gain is crucial to the debate about how to increase housing output. What role should it play and how does this fit with other incentive arrangements within the context of a reviving housing market?

31. S106 made an important contribution to the supply of affordable housing and community infrastructure at least until the credit crunch. Full data are no longer collected so its current contribution is less easy to quantify although it is likely still to be significant. In the period 2002/03 – 2007/08 over half of affordable housing completions included s106 contributions and in 2008 they provided over 30,000 new affordable homes. Research in this period suggested little evidence of developer resistance to s106.[16]

32. Before the credit crunch, planning gain was also substantial in terms of value: contributions secured in 2007-08 were worth almost £5bn, of which about half was for affordable housing (mainly delivered as houses rather than in cash).[17] In the same year, gross social housing investment in England was £7bn. Obviously this period provided a very favourable environment, with rising property and land values (house prices increased by 75% from 2002 to 2008). Yet s106 was playing a huge role at a time when overall housing output was 50 per cent higher than currently. It was far more significant than either CIL or the NHB is now (CIL is still tiny; NHB is currently worth £1bn, or one-fifth of what s106 provided in 2007/08).

33. It is likely that AHRs are still a significant contributor to affordable housing output, albeit not as significant as in 2007/08. Savills analysed DCLG data (see graph) and showed that the proportion of affordable housing coming through s106 fell below 60 per cent for the first time in 2010/11; this was at the height of the previous government's National Affordable Housing Programme.



Source: Savills using DCLG data (Table 1000) and HSSA data

34. Use of planning gain has been variable: some councils use it very effectively and have expertise in negotiating deals which work for both sides. Others have made less use of it or been less successful in negotiating deals that are successfully delivered. One study found that in part because they were concentrated on larger sites, planning gain was achieved in

only six per cent of all planning permissions.[18]

35. The downturn after 2008 saw mixed responses in the sector to s106, ranging from non-enforcement of existing obligations, negotiated changes or granting of new permissions with fewer obligations, or (perhaps surprisingly) to increases in affordable housing where some developers offered whole schemes to social providers or built the affordable element first to help their cash flow.

36. Experience suggests that, used intelligently, s106 agreements can give builders certainty and are not necessarily a financial burden. Savills have said that, at least outside central London, 'in the current market and at current volumes, the early cash flow from development of Section 106 affordable housing forms an integral part of the funding of private sector development'. They also point to its role in stabilising development of some sites, even though in the financial crisis it affected the viability of others. They conclude that 'the cash flow kept many private developers in business in 2009' – at the height of the financial crisis in the sector.[19]

37. The Coalition government has made sweeping changes to the planning system. It introduced the National Planning Policy Framework (NPPF) in March 2012, radically reduced the guidance relating to AHRs and removed the regional housing targets often used to justify them. Last April it said that 'unrealistic (affordable housing) conditions have meant no development, no regeneration and no community benefits'. It decided against solely a voluntary approach to renegotiation of AHRs, taking formal powers in the Growth and Infrastructure Act 2013 (GIA) to allow appeals against existing AHRs where a developer can show they make schemes unviable. DCLG claimed the changes could 'unblock 75,000 stalled homes'. It did not, however, comment on the potential impact on the Affordable Homes Programme. By this stage both developers and the government appeared to have forgotten the benefits of s106 during the crisis.

38. AHRs have also been restricted in scope in other ways: self-build, developments for market rent and schemes with less than ten units are all now either exempt or proposed to be exempt from having AHRs imposed.

39. CIL is different from s106 as it applies to all developments above a certain size, with some exemptions. Its aim is to share the burden of infrastructure costs, which tend to be borne disproportionately by large developments, more fairly across a wider range of schemes. It is only being slowly introduced as it depends on councils having a charging schedule, which few yet do. This may change during 2014 given the revival of the housing market. However, it remains a complex issue for local authorities, for example in setting appropriates rates for the levy, in striking the balance between CIL and s106, and in deciding how to apportion money collected via CIL (e.g. how many developer contributions are needed before work starts on a new school?). Government guidance is limited in scope.[20] As yet, there is little evidence of any impact by CIL on project viability.[21]

40. Provision of social housing is currently excluded from the scope of CIL. Guidance also makes clear that CIL should be the main form of planning gain in future, with deals for the provision of affordable housing taking a clear second place. There is a clear risk of a serious impact on the funding of affordable housing from planning gain as and when it is rolled out.

41. The government has a target of building 170,000 affordable homes over the period to 2015. In delivering it, providers have moved away from use of s106 towards acquiring large sites that they develop themselves. Grant is no longer generally available for schemes provided by s106 and the data only show 'nil grant' s106 schemes (they provided 4,820 units in 2012/13).

42. As the economy begins to move out of recession there has been a sharp increase in house prices, and, consequently, land values, particularly in London and the South East. Opportunities for planning gain are likely to grow, and it is important that changes to the planning system made as a reaction to recession do not prevent communities receiving a fair share of the benefits from development.

43. If roll-out of CIL is to continue, ARCH would argue that its scope should be widened to include the funding of affordable housing. Against this, it might be argued that trying to use CIL to fund both community infrastructure and AHRs is like trying to get a quart from a pint pot. This is true to the extent that CILs will never be adequate as the sole source of funding for either infrastructure or affordable housing. However, the amount of planning gain varies substantially from site to site and from area to area, as does the requirement for infrastructure investment and priority for affordable housing. Widening the scope of CIL would provide greater scope for councils to tailor planning obligations to local circumstances and priorities. It would also provide greater scope for them to negotiate the development of mixed communities. The alternative of moving to a strict separation of private from affordable housing provision risks perpetuating the social segregation and concentration of poorer households in developments stigmatised as "sink estates".

44. Use of planning powers can make an important contribution both to funding the infrastructure necessary to make new homes succeed, and to the supply of affordable housing. However, it has important limitations. Chief among these is that that division of the benefits of development is stacked in favour of the developer. In negotiating a s106 the council must rely on a conservative estimate of the house price inflation and developers profits. If this turns out not to have been conservative enough, the developer can seek to renegotiate, and if not satisfied, use the power in the GIA to appeal against the terms of the agreement. However, renegotiation is a one-way street. Councils are not able to renegotiate additional community benefits when house prices rise faster than expected. And councils have no effective power to influence the speed at which sites are developed, leaving open the possibility that developers, having persuaded councils to reduce contributions due under s106 in view of the market downturn, may nevertheless defer construction until house prices rise again.

Partnership arrangements

45. Partnership arrangements come in a variety of forms. Those discussed here have a number of features in common. They involve a partnership or joint venture between a council and one or more partners, typically a developer and often a housing association, sometimes an institutional investor. The council contributes land and shares the risk and benefits of developing it. A recent LGA report[22] identifies the following types, most of which are in use in one or more ARCH member councils:

    1. Local housing company (e.g. Sheffield) – a form of joint venture between a council and private developer originally piloted by the HCA;
    2. Special purpose vehicle (e.g. Barking & Dagenham) – council provides land, private sector partner provides finance; dwellings may be provided on a lease so that land eventually reverts to the council;
    3. Local asset-backed vehicle (LABV) (e.g Gateshead) – council provides land, partner provides finance and skills and capacity to deliver;
    4. Joint venture (e.g. Oxford Barton LLP) – council and private commercial venture; council provides land, partner provides funding; risk and rewards are split between the partners;
    5. Pension Fund Investment (e.g Manchester) – a long-term partnership arrangement in which the pension fund invests in housing development; the council can provide land to increase the viability of the model.

46. These arrangements involve a formal long-term partnership or the establishment of a company in which the council is normally a minority shareholder. This enables the risks and rewards of development to be shared appropriately among the partners, so that the council benefits fully from any planning gain associated with the development, and does not need to rely on s106 or similar arrangements. Homes may be provided for sale, including shared ownership, or letting at market or sub-market rents. If let they are let on assured tenancies and the right to buy does not apply.

47. Nearly all examples rely on the council providing land, usually land it already owns. However, in the context of an expanded housing construction, this model provides the opportunity for councils to acquire additional land for development at existing use values, by compulsory purchase if necessary, ensuring that the community shares in the increase in value arising from designation for housing.

48. Versions of this model appear to have some potential to increase the supply of homes for market rent, by using contributions of land to provide institutional investors with a reasonable expectation of an adequate rate of return on their investment – in some areas at least. Several Local Housing Companies have been designated by the HCA as registered providers and are eligible to receive capital grant. In the past this has enabled them to provide new homes for letting at social rents, although under current HCA policies grant is

only available to provide housing at "affordable" rents.

49. Prospects for this model are, however, limited by the willingness of private partners to invest in housing development and the rate of return they expect on their investment. Set-up and governance costs associated with special purpose vehicles can be substantial, and the associated legal issues are complex and require specialist advice and support. The LGA report includes the following comments:

50. **Barking & Dagenham – Special Purpose** Vehicle[23]

" Setting up a partnership with an institutional investor takes time and money. It takes longer and is more complicated that using more traditional forms of borrowing such as the Public Works Loans Board".

Barton Oxford LLP

"A joint venture requires resourcing by the council. Oxford have committed a lot of time to the partnership and other councils considering this approach will need to think about the demands on officer and member time. The skills and commercial experience needed to set up a successful joint venture will also be critical to the process."

51. While such models have been used with success, they are likely to be less attractive to smaller authorities looking at smaller sites and programmes, where the set-up and overhead costs form a significant obstacle.

Local authority-controlled companies

52. A growing number of councils have set up arms-length companies which they wholly own or control to develop housing for sale or rent, sometimes in conjunction with the development of commercial property. Examples include South Cambridgeshire, Thurrock and Ashford. Housing provided under such arrangements is outside the Housing Revenue Account (HRA) and, if let, is let on assured tenancies and not subject to the Right to Buy. Such housing development is classed as a trading activity, which means that councils can only do it through a company. However, the set-up and operating costs of such companies can be much lower than those of a joint venture with a private partner, particularly where the council is the only shareholder. Any borrowing by the company counts as public borrowing, and in effect is part of the council's borrowing and subject to prudential guidelines. However, because outside the HRA, it is not subject to the debt caps imposed on HRA borrowing.

53. One potential use for such companies is to acquire, develop or lease properties for market rent, perhaps offering longer term tenancies than are normally available in the private market, drawing on the management expertise of the council's mainstream council housing operation and the proximity of local offices to provide a cost effective management and maintenance service to market renters.

54. Gloriana Thurrock will be a housing company wholly owned by the council and able to build new homes on council owned or acquired land on a site by site basis. The financial model assumes that most of the new homes will be let at 80% of market rent, with the balance sold outright or through shared equity or similar schemes. The initiative began from the council's frustration with the number of undeveloped or stalled sites in the district, and the reluctance of private developers to invest, coupled with the poor quality of much new private developments in the district. The new company should enable the council to ensure that development gathers pace by enabling the acquisition and development of sites and ensuring an improved standard of development. It has the added advantage that the council also owns and manages a substantial council housing stock and has significant HRA borrowing headroom [check numbers]. This enables it to mitigate the risk associated with the housing company's operations by having in reserve the option of acquiring a proportion of the new homes for the HRA if market conditions make this advisable.

Direct provision of new council housing

55. Until the 1980s, councils were the major providers of new social housing, and, at their peak output in the 1960s and 1970s, regularly contributed over 100,000 new homes a year. Housebuilding has not reached 200,000 a year for a sustained period since councils were building at volume. After three decades during which councils were out of favour as providers of new housing, the introduction of HRA self-financing from April 2012 has given councils with housing a new opportunity to begin building again, and the majority are taking advantage of it, although as yet on a relatively small scale.

56. The introduction of self-financing has given the 167 councils which own housing – with and without ALMOs – the opportunity to plan long-term to invest in their existing stock and build new homes. An ARCH survey in 2012 showed that over three quarters of councils were planning to build new homes in the next five years, 20 – 25,000 homes in total.

57. The amount of borrowing available to councils to finance HRA expenditure is limited by a debt cap linked to historic borrowing levels. Most councils began self-financing with some headroom for additional borrowing, but some 30 did not. If HRA borrowing were not limited by debt caps but subject only to prudential rules similar to those governing other council borrowing (in simple terms the ability to borrow as much as they could safely afford to repay from expected rent income) all, or nearly all councils could, in theory undertake additional borrowing to build more homes.

58. The ARCH survey asked respondents to estimate how many additional homes they could build if debt caps were removed. Responses suggested that around 60,000 additional homes could be provided over five years, raising the annual output of new council homes to 16-17,000 a year. However, it is clear from analysis of the CLG self-financing data that councils have in principle the financial capacity to provide more than this, up to perhaps 20,000 homes a year, from projected rent income, and without additional subsidy from

government grant or the sale of assets. This implies that council responses reflected other constraints on building, including the current development capacity of the council and the local construction industry, and the current availability of suitable land.

59. This estimate of a potential for 20,000 new council homes a year is based on the estimated amount of cross-subsidy for new housing that could in principle be generated from rents on existing homes. Additional sources of subsidy could support a further increase in new council output, or alternatively reduce the requirement for additional borrowing. Councils are in principle, if registered with the HCA, eligible to receive capital grant, although this is currently tied to the provision of homes at "affordable" rents. An alternative currently being promoted by the HCA and the Government is the sale of "high value" vacant council homes, predominantly those located in areas with high land values, to finance the construction of new homes in areas where land values are lower. On a limited scale, councils will wish to take advantage of such opportunities, where they exist, as part of a strategic approach to asset management. However, grandiose estimates of the potential of this approach, such as that made by Policy Exchange [24], imply the virtual elimination of social housing from large areas, reinforcing social segregation and putting an end to established mixed communities. Its recommendation that all homes above the regional median house price should be sold is made with the conscious expectation that social housing would be phased out in most of central London, and all council housing in the Cotswolds relocated to Swindon.

60. Reform of current rules governing the HRA could both increase the potential for new council house building and enable councils to contribute more effectively to the construction of new homes for sale and market rent by drawing on the financial strength of the HRA. Under current arrangements councils may sell vacant HRA dwellings and use the receipt to finance capital expenditure. This arguably enables them to build homes for sale in the HRA and use the receipts to finance construction of homes for social rent, using the surplus (sale price less cost of provision) as an additional cross subsidy for social housing. Where this approach enables the council to expand both the supply of homes for sale and for social rent it should be encouraged.

61. Current rules do not permit the provision of homes for market rent within the HRA, except where the council has chosen to operate a Pay to Stay scheme under which they charge higher rents to tenants with household income over £60,000. Councils which have set up companies to provide market rented housing do so in the expectation of trading surpluses which, at present, can only be credited to the General Fund. Allowing them to build and manage homes for market rent within the HRA would have the advantages both of spreading the risks associated with this activity across the HRA as a whole, and allow trading surpluses to be applied to the provision of homes for social rent.

62. All council housing within the HRA is currently subject to the Right to Buy. One risk associated with expanding council house building is the loss of a significant number of new dwellings through the exercise of RTB. ARCH does not wish to comment in this submission on the merits of the current entitlements and discounts available to tenants under RTB. What is most important, we would argue, is that there are adequate arrangements in place

to enable councils to replace sold dwellings on a one-for-one, like-for-like basis. Current arrangements for RTB replacement are unnecessarily bureaucratic and restrictive. They are claimed by the Government to enable one-for-one replacement at a national level, although there is as yet no evidence to show that this will be achieved. However, replacement of a home sold in Lincoln by one in Lambeth is of no comfort to applicants on the housing register or homeless in Lincoln, and the commitment should be to enable one-for-one replacement in the local authority area wherever possible.

63. Most larger councils have uninterrupted experience in running large scale housing development and regeneration schemes and the challenge of scaling up their development programmes to increase the output of new homes is essentially incremental. Many smaller councils have had little experience of building new homes for some years and need to rebuild their development capacity from a standing start. They may need support, possibly including the creation of development consortia which enable them to share staff with key expertise and realise economies of scale.

Treating council housing fairly

64. Each of the delivery options reviewed above has a role to play in raising housing output to 200,000 homes a year. Each has advantages in particular local housing market conditions and works less well in others. Councils will need to have all of them at their disposal in choosing appropriate responses. However, we want in this submission to make the case in particular for a major expansion in direct provision of new housing by councils. Direct council building has three main advantages:

    1. There is substantial room for additional provision on land already owned by councils, including infill and redevelopment of garage sites and other redundant buildings on existing estates; there are many council-owned sites where direct building is simpler and more practical than disposal to another developer;
    2. Direct provision is less costly and time-consuming to administer than complex and legally intricate partnership arrangements; where these are not necessary they are better avoided. Their legal complexity is itself partly a product of legal issues around the HRA and council borrowing; better to simplify that.
    3. Council HRAs can support additional investment of £20 - £25 billion without additional external subsidy.

65. We have shown that the council housing sector has the financial capacity to support the provision of perhaps 20,000 new council homes a year without external subsidy, but is prevented from doing so by borrowing caps imposed by the Government. The borrowing caps are there because the Government takes the view that council HRA borrowing contributes to the Public Sector Net Borrowing Requirement, reduction of which is the primary objective of the Government's austerity measures.

66. As argued in two reports published by the National Federation of ALMOs – *Let's Get Building* and *Treating Council Housing Fairly*[25], the UK's definition of what constitutes public borrowing differs from the international one used by other EU countries and bodies such as the IMF, OECD and credit rating agencies by including borrowing by public corporations alongside borrowing by central and local government. The international definition recognises that public corporations, unlike governments, are trading bodies whose borrowing is repaid from trading income and not from general taxation.

67. Because of the operation of the HRA ring fence, international accounting rules class directly managed council housing services in the UK as public "quasi-corporations" – part of the public corporations sector. This approach acknowledges that borrowing to finance new homes in the HRA will be repaid from rental income without recourse to the taxpayer. There will of course be implications for government welfare expenditure given that a proportion of new tenants are likely to receive Housing Benefit, but this is no greater, and may well be less, than the impact of providing the same number of additional homes

through housing associations or other social providers.

68. Establishment of Municipal Housing Companies has been proposed as a way to get round current restrictions on HRA borrowing. David Orr has argued:

> Instead of direct ownership and management of social homes, or contracting this to arm's-length management organisations, we should offer local authorities the chance to transfer their stock to proper municipal housing companies.
>
> In this model, the company would own the stock and all other business assets, own the rent and the business plan, and have its own board – but the local authority would have a controlling interest on the board.
>
> In exchange for setting up this model, we would argue that the government should allow companies to borrow, secured against the housing assets and repaid through rental incomes, which would be outside the classification of public debt. The obligation to meet the full cost of the debt repayment would rest solely on the housing company and its residents.[26]

69. Such companies would clearly be public corporations, organisationally separate from the councils which controlled them. However, Orr is wrong to argue that their borrowing, under current UK rules, would not be classified as public debt. It is not just council HRA borrowing that is added into the UK definition of Public Sector Net Debt, but the borrowing of all UK public corporations. There is a strong case for reform of the UK rules to bring them into line with international practice, as we have argued, but it applies to council HRA "quasi-corporations" just as much as public corporations, including municipal housing companies.

70. Nor, under current legislation, could councils transfer housing to municipal housing companies without the support of tenants by ballot. On Orr's proposal tenants would be offered the same invidious choice that was available before self-financing – transfer to a new landlord and get more investment, or stay with the council and do without. Despite this, tenants in many areas voted decisively to stay with the council, and would be likely to do so again. It would be unfair and divisive to return to a situation where they were asked to make that choice.

71. In summary, we would argue that it is simpler, more consistent and fairer to tenants to reform the rules on public borrowing rather than try to make the case for spurious "exceptions".

Infrastructure and incentives

72. An earlier section reviewed how effective the use of planning obligations has been as a source of funding for affordable housing and infrastructure. It expressed concern that the use of planning obligations to fund affordable housing has fallen out of favour with the Coalition government, and was doubtful whether the Community Infrastructure Levy will be as effective as the system it is replacing in raising finance for infrastructure.

73. The New Homes Bonus (NHB) has been championed as promoting housing supply because it is a 'bottom up' incentive as against the 'top down' requirements imposed through the discontinued Regional Spatial Strategies. NHB replaced the Housing and Planning Development Grant (HPDG – worth a modest £250m in 2010/11) which was described as 'highly bureaucratic and ineffective'. NHB provides councils with a 'bonus' equivalent to six years of extra council tax for every newly built property or empty property brought back into use, with a further supplement for new affordable housing.

74. The bonus is a mix of new funding and sums top-sliced from formula grant. Total allocations will be £2.2bn over the four years 2011-15, of which £1bn is additional grant. Top-slicing grows to £418m in 2013/14: a significant amount.

75. The NHB was expected to lead to an extra 144,000 homes over ten years. The expectation was criticised as being 'fairly modest' set against likely falls in output due to the ending of regional targets. Research for the Policy Exchange in 2012 suggested these falls amounted to 272,720 houses across England.[27] The NHB was also described as 'modest' compared to incentive schemes in other countries (e.g Switzerland) where local tax is a much bigger proportion of local authority budgets, so an increment to such tax is a much bigger sum than is typically paid through NHB.[28]

76. In March 2013 the NAO criticised DCLG claims for the NHB as 'unreliable' and also said it was difficult to identify its effects, especially as there was no early monitoring.[29] After site visits, it found little evidence that the bonus was influencing planning decisions. It pointed out that by the sixth year payments would grow to £1.6bn with some councils gaining substantially while others suffer big losses. High value areas, such as inner London, are big winners, whereas northern councils, even when they are championing housing growth, receive small shares of the pot available. Furthermore, the government has recently decided to pool 35% of the bonus fund to share among Local Enterprise Partnerships, further reducing the incentive effect.

77. The government is re-evaluating the NHB in the wake of the NAO and PAC investigations, and results are due this Spring. Retaining NHB could only be justified if it can be shown to have achieved worthwhile extra housing output, since otherwise it is simply a redistribution mechanism in which low-value areas lose out.

78. It is noted above – in comparing the impact of NHB with a similar scheme in Switzerland - that NHB would be more of an incentive if council tax contributed a higher percentage of local expenditure. In considering what might replace it, one option that should be looked at seriously is the long-overdue reform of the local government finance system to provide a more buoyant tax base that responds quickly and proportionately to growth in local population and prosperity.

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[1] The assistance of John Perry in preparing this submission is gratefully acknowledged.
[2] Resolution Foundation (2013) *Home Truths: How affordable is housing for Britain's ordinary working families?*
[3] Much of the analysis in this section is based on the *UK Housing Review 2014*, to be published by CIH in April.
[4] Holmans, A. (2012) *Interim Revised Estimates of Future Demand and Need in England in 2006 – 2026*. Cambridge: CCHPR.
[5] NHPAU (2008) *Meeting the housing requirements of an aspiring and growing nation: taking the medium and long-term view.* London: DCLG.

[6] DCLG (2013) *Household Interim Projections, 2011 to 2021, England.* London: DCLG.
[7] DCLG (2014) *English Housing Survey: Headline Report 2012-13.* London: DCLG.
[8] Resolution Foundation (2013) *Home Truths: How affordable is housing for Britain's ordinary working families?*
[9] Clapham, D. *et al* (2012) *Housing Options and Solutions for Young People in 2020.* York: JRF.
[10] DCLG (2014) *English Housing Survey: Headline Report 2012-13.* London: DCLG.
[11] Wallace, A. (2010) *Public Attitudes to Housing.* York: JRF.
[12] DCLG Live Table 1000.
[13] Defined as those in deciles 2-5 of the working-age household income distribution. See Resolution Foundation (2013) *Home Truths: How affordable is housing for Britain's ordinary working families?*
[14] See www.homesandcommunities.co.uk/ourwork/private-rented-sector
[15] Resolution Foundation (2013) *One Foot on the Ladder: How shared ownership can bring owning a home into reach*. London: Resolution Foundation.
[16] Monk, S. (2005) 'Making Planning Pay?' in Wilcox, S. *UK Housing Review 2005/2006.* Coventry: CIH.
[17] Crook, A.D.H., et al. (2010) *The incidence, value and delivery of planning obligations in England in 2007-08.* London: DCLG.

[18] Crook, *ibid.*
[19] Savills (2013) *Additionality of Affordable Housing*. Report to the G15. London: Savills Research.
[20] DCLG (2011) *Community Infrastructure Levy: An overview.*
[21] Burgess, G., Crook, T. and Monk, S. (2013) *The changing delivery of planning gain through Section 106 and the Community Infrastructure Levy.* Cambridge: Centre for Housing and Planning Research.
[22] Local Government Association (2014) *Supporting housing investment: A Case Study Guide*
[23] LGA op cit
[24] http://www.policyexchange.org.uk/publications/category/item/ending-expensive-social-tenancies
[25] National Federation of ALMOs, *Let's Get Building* (2012), *Treating Council Housing Fairly* (2013)
[26] David Orr, www.theguardian.com/housing-network/2013/oct/08/municipal-housing-companies
[27] Tetlow King Planning (2012) *Research on the Impact of the Impending Revocation of Regional Strategies on Proposed and Adopted Local Housing Targets across England.*London: Policy Exchange.
[28] Pawson, H. and Wilcox, S. (2010) *UK Housing Review 2010 Briefing Paper.* Coventry: CIH.
[29] NAO (2013) *The New Homes Bonus.* London: NAO.