APPENDIX B

SALISBURY DISTRICT COUNCIL
OPTIONS FOR NEW AFFORDABLE HOUSING IN SALISBURY
Final Draft Report July 2008

Contents

1 Introduction

1.1 Background

Following a stock transfer 'no vote' in 2006, Salisbury District Council is now developing its plans for the future maintenance of its housing stock, the development of the housing service and for the provision of new and replacement affordable housing. Given pressures within the business plan, the council is keen to understand the potential:

- To use existing assets such as housing, other buildings and land in a more proactive way to better meet housing needs,
- For building new local authority housing in a local housing company and

Drawing upon our work with the council on the development of the Housing Revenue Account (HRA) business plan and on the national self financing pilot project, HQN were invited to prepare an initial briefing report on the progress nationally towards innovation in new build from local authorities.

An initial draft of this note was presented to members at Salisbury in June; the outcome was an in-principle decision to establish a project to further investigate the potential. This final note is presented to the council for discussion at the Joint Implementation Committee for *One Wiltshire* on 9th July.

The direction of travel within the national agenda for new build and for the relaxation of financial constraints expanding the role of local authorities is ore favourable than perhaps for a generation. This direction of travel is more than adequately exemplified by the announcement of a fundamental 'root and branch' Review of Council Housing Finance, in which all aspects of HRA finance are being reviewed. The Review began in March following a pilot project looking at HRA 'self financing' - a short progress report on the review is set out below.

Our work with the council on the HRA business plan indicated that there will be long term challenges in making the plan more financially viable. One key area of enquiry therefore might be consideration of the future of existing stock in the context of opportunities for redevelopment to promote greater sustainability in the future.

Together with other significant policy initiatives (discussed below), the council will be able to take advantage of this policy future and develop solutions for both the existing stock and for the delivery of new affordable housing as part of an overall strategy for the managing of its assets.

1.2 Background

The Government is very keen to support innovation in new development schemes, be that in design or in the financial models for delivery. Fourteen pilot projects have been established with other authorities and many others are progressing plans. The council is exploring the potential for new build in the Salisbury context given this progress. This paper sets out the following:

1. A summarised commentary on national progress for new build local authority housing,

2. Suggested areas to further develop thinking and feasibility with some initial pointers towards the establishment of a viable financial plan.

A key objective for all councils within such a review is to understand the legal and financial boundaries in the context of Government policy. Whilst the policy signs are positive, there remain some barriers to the delivery of some ideas and a clear awareness of these is critical to inform future thinking.

Whilst this paper is intended to act primarily as a discussion document, we have carried a short and illustrative modelling exercise using *average* Salisbury data. We have set out within the report some suggested factors which might achieve the financial viability members will wish to see in order to minimise risks in the future and the illustration indicates that a suitable set of proposals could be developed relatively quickly without the need for significant or ongoing call on council capital resources.

2 National policy progress: from the Housing Green Paper to date

2.1 Housing Green Paper

The first public signal from the government to encourage greater flexibility in the provision of new affordable housing came with the blueprint ‘From Decent Homes to Sustainable Communities’ published in June 2006. Prior to this, the Housing Corporation had already announced that it would offer Social Housing Grant to non-registered bodies (ie those that are not Housing Associations) as part of its preparations for the 2005 National Affordable Housing Programme.

Subsequently, the Housing Green Paper of July 2007 promoted a role for local authorities in both facilitating and providing new affordable housing, announcing 14 pilot Local Housing Companies and extending the ability of these companies and Arms Length Management Organisations (ALMOs) to apply for Social Housing Grant (SHG).

The Housing and Regeneration Bill, due for Royal Asset in the autumn of this year, also makes provision for exploring the relaxation of the negative subsidy rules for newly built HRA stock.

2.2 National progress

A majority of ALMOs and a significant minority of authorities are exploring in detail the options to build again. Eight ALMOs and two local authority companies became pre-qualified for SHG in 2007 and a further sixteen ALMOs and a number of authorities applied in 2008 and received accreditation last week. Three ALMOs (at Brent, Derby and Sheffield) and one authority (Knowsley) have received grant for their schemes in the 2008 programme. Further bidding rounds are taking place in 2009 and 2010.

The Housing Corporation and fledgling Homes and Communities Agency (HCA) are known to be encouraging applications from authorities and ALMOs as a means of accessing council land for development.

The main driver is the land available to local authorities (estimated up to 60,000 properties nationally) which the government and HCA wish to see developed with new housing. Authorities may be encouraged to transfer their land into a company in which it had an interest rather than transfer land at sub-market value to housing associations. It is recognised that this could be a useful way of supplementing housing association build programmes although the government remains committed to the overwhelming majority of new affordable housing being provided by housing associations.

2.3 What are the options?

For authorities in Salisbury's position (and therefore for *One Wiltshire*), the main options are to:

- Set up a new Local Housing Company (LHC) to develop and own properties
- Build new properties within the HRA.

Building HRA properties remains constrained by negative subsidy and the 75% pooling rules applying to Right to Buy sales receipts, and as there are currently no signals that grant will become available for the building of HRA stock in the future, the main option is to establish a new LHC.

2.4 The future of Subsidy and the Review of Council Housing Finance

The national Review of Council Housing finance is exploring the options for reform of the national system of HRA subsidy. For an authority to make a sustained contribution to new development and asset management over the longer term requires greater freedom to use existing HRA assets more flexibly. Housing associations are able to use the 'critical mass' of their existing stock to achieve greater value in development, both in terms of the costs of developing new housing and the ongoing costs of management and maintenance.

A pilot project investigating the potential for authorities to leave the HRA subsidy system and become 'self financing' through a one off adjustment to their housing debt has recently completed. The main conclusions were that there are significant benefits and efficiencies to be gained from local decision making a self financing HRA. However, the project identified some endemic long term problems with the HRA subsidy system that helped trigger the current National Review of Council Housing Finance.

The Government appears committed to finding a more sensible long term solution and the review could represent a real opportunity to make a fundamental change to the future financing of council housing. The review is unlikely to lead to a worsening of the financial position nationally (and therefore for Salisbury or *One Wiltshire*) - the *extent* to which the position improves in the medium to long term and whether the government will be prepared to allow financial freedoms locally are the key issues at stake.

At this stage, it is difficult to predict the outcome of the review. Most authorities are therefore pressing ahead with the LHC approach.

2.5 The Local Housing Company approach

LHCs are being developed with both majority local authority ownership or with majority ‘other’ ownership. From a financing perspective, the main distinction is the treatment of the borrowing and investment as ‘off balance sheet’ (ie outside of public expenditure constraints) for the LA minority owned company.

The overwhelming majority of LHCs under consideration will have 100% authority ownership and will be ‘on balance sheet’ with any borrowing counting as local authority prudential borrowing. The LHC would have a non-executive board of directors drawn from senior members, management and other professional people. ALMOs are for these purposes treated the same LHCs as they are 100% owned by the council although many are considering the establishment of development subsidiaries.

3 The Local Housing Company model

3.1 Key features

The delivery of new housing through a LHC is always predicated on the availability of authority land to put into the scheme. Transfer of the land (usually from the HRA) would be at a sub-market price (usually, but not exclusively, nil or nominal). The company’s accounts would be under the Companies Acts and would be consolidated within the council’s accounts at the end of the year.

The main features of a LHC and the stock owned by it are:

- There is some flexibility on rent policy as the properties do not come under the rent restructuring regime – there is a balance to be struck between financial viability and affordability.
- The tenancies are outside of the HRA (and are therefore Assured) and do not have the Right to Buy unless included as part of the tenancy terms.
- The landlord would be the LHC, the properties managed and maintained for a fee under a management agreement with the existing Landlord/Housing Services function.

- Development is likely to be carried out by developers/housing associations in a form of development agreement.
- Surpluses on the LHC's activities would be subject to corporation tax unless established as a charitable subsidiary – the latter option however might constrain future activities.
- There are other taxation issues including VAT and Stamp Duty Land Tax, all of which need to worked through as part of scheme appraisal work, but none of which are seen as barriers to begin development.

Most commonly, authorities are looking at the following sources for land to go into schemes:

- In fill and garage sites within and around existing council housing estates
- Redevelopment of defective, high cost or otherwise redundant housing.

We understand that there are opportunities throughout the Salisbury district for schemes to be developed.

Larger land plots and most of those outside the HRA will continue to be viewed as housing association/developer sites given the economies of scale of existing providers unless subject to large scale regeneration where there may be a preference locally for redevelopment through the authority.

3.2 Financing developments

Social or sub-market rents are insufficient to raise the loan finance to build new homes. There is *always* a need for an up front, 'grant' element to help finance schemes. In order to get their companies up and running, most authorities and ALMOs are finding finance from routes other than SHG – the suggestion is to build up a track record before approaching the HCA for grant status. The main sources of finance for this 'up front' element are:

- Cumulative receipts or other amounts available to the council (eg from the disposal of HRA non-dwelling assets)
- Section 106 commuted sums from developers
- Cross-subsidisation from the sale of some properties on the open market or for shared ownership: this is the most common way of getting schemes going – for example 'build two: sell one, rent one'; this helps to keep reliance on 'up front' capital resources to a minimum whilst generating future rental streams to support further developments.

For schemes requiring some prudential borrowing, this is usually being borrowed by the authority and on-lent to the LHC as part of a loan agreement. The borrowing would count as 'General Fund' borrowing and be treated in the same way for accounting purposes.

There are a range of legal (and some accounting) issues which have arisen to date and some of these remain unresolved at this time although there is intense pressure on government to further relax the rules.

4 High level financial viability

Although we have not carried out any detailed financial appraisal work on any particular proposed scheme or site, we have been able to set out some thoughts on future financial viability given '*average Salisbury assumptions*' for new housing. The conclusions are set out below.

4.1 Establishing the average Salisbury development

We have generated a high level viability forecast for an illustrative '100 unit' scheme in Salisbury, on vacant land currently held in the HRA. The key factors are set out in the table below.

Description	Factor	Comments
Properties	100 x 2 bed houses	Likely to be a property mix in practice
Build cost	£110k per unit	Average for developing associations all in including overheads and design
Sales price	£240k per unit	Market sale total net of sales costs
Land cost	Nil cost transfer from HRA	May still incur Stamp Duty Land Tax on transfer per assumed value
Rental	£85 per week	Social rent levels in Salisbury
Running costs	£700 / property / year	Includes management and maintenance
Major Repairs	£600 / property / year	Average to fit in with life-cycles

4.2 How the business might look with different mixes of tenure and different mixes of finance

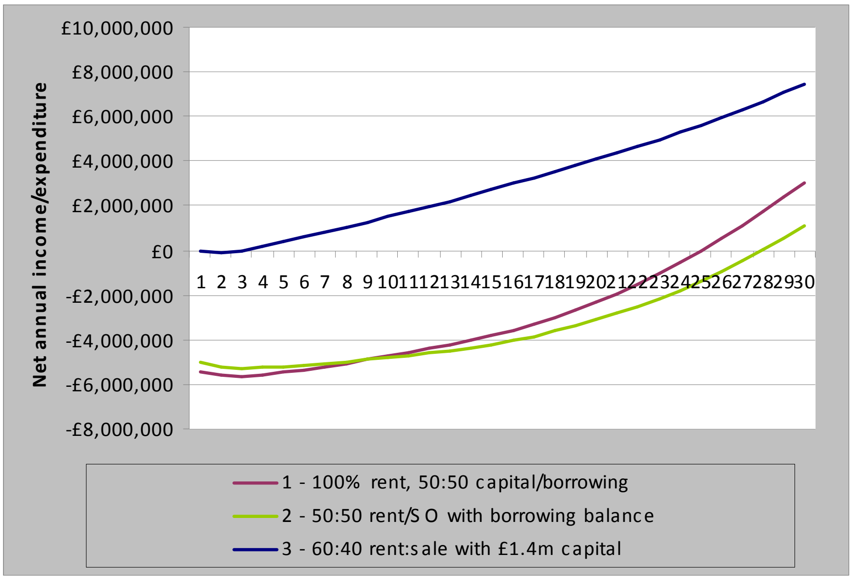
The scheme cost for the above illustration would be £11million. The chart overleaf shows how the net income/expenditure profile of the company would be different depending upon three approaches to the tenure mix and financing of the scheme:

1. 100% rented scheme with 50:50 up front council resources and borrowing
2. 50% rented, 50% shared ownership scheme part funded from proceeds of sale of shares in shared ownership properties and remainder financed by borrowing
3. 60% rented, 40% market sale scheme part funded from proceeds of sale of shares in shared ownership properties and remainder financed by council resources.

The chart shows that:

- For a 100% rented half financed through up front resources and borrowing, there would be a need for £5.5million resources plus £5.5million borrowing. Rental streams would repay the borrowing after 24 years.
- For a 50:50 rent:shared ownership scheme with no up front capital resources, borrowing would need to be a little less than £5.5million and repaid after 27 years.

- However, for a 60:40 rent:market sale scheme with no borrowing, the reliance on up front resources is reduced to £1.4million and there is no borrowing; rental streams grow quickly to over £1.5million net per year by year 10.



The above is merely an illustration at this stage but serves to highlight that there are certainly a combination of circumstances and assumptions which would ensure both a low requirement for the up front investment of capital resources and future financial viability to enable further new development. There are sufficient factors which can be adopted too ensure that risks to the council are minimised.

5 Future actions

The council and *One Wiltshire* should be able to take advantage of the favourable policy environment for new build housing in the forthcoming period.

A local housing company could be established almost immediately and our initial scoping work suggests that there are opportunities to begin developments in which:

- Reliance on initial up front resources from the council can be reduced through cross-subsidisation from other resources.
- Future rental streams are able to cross-subsidise further development without an ongoing call on council capital resources.

Providing potentially suitable sites and schemes can be identified, a more detailed modelling and development appraisal exercise can be undertaken.