



Eastleigh Borough Council Options for affordable housing delivery Summary report

FINAL REPORT
15 December 2020



1. Introduction

Eastleigh Borough Council has identified a potential pipeline of properties that will be classified as affordable housing within an extensive programme for future residential developments. Savills Affordable Housing Consultancy was appointed to assist the Council in assessing the options available to take ownership of the affordable homes in particular focusing on:

- The issues arising from reopening a Housing Revenue Account (HRA)
- Alternative approaches that the Council could utilise to provide affordable properties outside of an HRA
- The prospects of engaging in affordable housing delivery without an HRA or otherwise achieving Registered Provider (RP) status.

This summary report provides a high level commentary on the key issues for the Council and makes suggestions as to what may be an appropriate way forward.

This report is accompanied at annex 1 by a detailed report that addresses all of the key issues that arise from the legislative, financial and accounting provisions and frameworks that apply to the HRA and local housing company options. During the course of this review, we have also prepared a high level financial model to test the financial viability and sustainability of the delivery options making a series of assumptions in relation to the forthcoming development at One Horton Heath, which is an extensive programme with over 800 homes. Whilst these are illustrative and do not represent a formal appraisal, the modelling does highlight the key differences between the HRA and company options. The modelling outputs are included within the annex.

2. Reopening the HRA: key features

The Council has a range of powers to acquire and provide housing. The choice of power has financial and accounting implications. The principal powers utilised are:

- Section 120 of the Local Government Act 1972 – generally used to provide temporary accommodation
- Part II of the Housing Act 1985 – to provide settled long-term council housing accommodation; and is linked via the Local Government and Housing Act 1989 to accounting in an HRA
- Part 1 of the Localism Act 2011 (the General Power of Competence) – generally to provide housing in subsidiary companies on a more flexible basis than provided for in an HRA.

The Council is therefore able to use Part II 1985 Act powers to provide social and affordable rented homes for the long-term and account for them in a reopened HRA.

The Local Government and Housing Act 1989 prescribes how the HRA should be operated:

- It is ring-fenced within the General Fund to cover the provision of landlord services
- Income and expenditure must balance and the HRA reserve must not be in deficit
- There is a separate capital programme with distinct sources of finance
- There is a separate accounting and debt framework for the HRA.

When the Council originally closed its HRA in the 1990s, the financial and operational constraints on the HRA were severe. Following a succession of legislative changes culminating in the abolition of the former HRA debt-cap in 2018, all HRA income is now able to be retained and spent locally, and sustainable borrowing and investment can be undertaken in line with the wider local authority Prudential Code.

If affordable provision is fewer than 200 homes, the Council could apply to MHCLG for a waiver not to have to reopen the HRA. If provision is more than 200 homes, then the Council must reopen the HRA.

As there is the ambition, a realistic pipeline and a set timeframe to achieve the provision of much more than 200 social and affordable homes, the Council has the option to reopen the HRA from the outset.

There are some administrative issues associated with operating a separate HRA but these are not felt to be onerous. The Council has the capacity internally to acquire the necessary specialist knowledge and skills to operate an HRA. There are no additional governance requirements for the HRA other than the requirement to budget for and report on a separate account.

The HRA is able to be make a contribution to the costs of running the authority as whole - there would therefore be the opportunity to charge a proportion of corporate and central costs to the HRA (allocated in line with best accounting practice).

The HRA would have a separate measure of debt and the finance charges associated with the HRA may allow the Council to achieve further value in its overall Treasury Management strategy; the recent reduction in PWLB rates in the November Spending Review announcement has reinforced this position. The debt measure would be zero if the HRA was opened from the outset; experience shows that a “split” into a new HRA for properties that are already in place in the General Fund can prove complex.

Provision of affordable homes in the HRA means that the Council would become a Public Registered Provider of Social Housing subject to Regulatory Standards set by the Regulator of Social Housing. Rents and rent increases would need to be set in line with the Rent Standard. RP status allows Homes England grant to be claimed to help finance development and delivery.

Tenants of HRA properties would have secure tenancies, which are generally lifetime (unless the Council opts for fixed term tenancies) which carry the Right to Buy. Right to Buy sales would be subject to the Cost Floor – meaning that irrespective of the discount applying to a sale, a property could not be sold for less than the capital costs incurred in the previous 15 years (including development and acquisition).

Properties held in the HRA are subject to restrictions over their disposal, generally to ensure that property disposals represent value for money; disposals to companies and RPs are restricted even at sub-market rates.

The HRA would not generally be able to hold market rent homes unless this was explicitly to cross-subsidise affordable homes – in any case these homes would be let on secure tenancies.

In the short term, the Council would need to engage a third party to provide housing management and repairs services; this could be a partner RP. In time, and depending on scale, the Council would be able to develop its own in-house landlord service.

Operation of a reopened HRA might therefore be felt to offer the “path of least resistance” to the scaling up of affordable housing provision by the Council to above 200 homes, borrowing at the cheapest rates with minimal additional governance and the opportunity to share existing corporate costs.

The principal downsides are usually felt to be restrictions on rents and rent increases, asset disposals and the Right to Buy.

3. Provision within the General Fund

Housing provided solely for temporary accommodation would be held within the General Fund, although many authorities are also utilising HRA properties on a temporary basis to meet these duties in the short term given rising pressures on homelessness.

Provision of long term settled affordable rented housing could only be provided in the General Fund up to 200 homes and subject to MHCLG waiver on reopening an HRA. If there was not a realistic path to the provision of more than 200 homes, this might suggest holding within the General Fund.

4. Provision within an affordable Local Housing Company

The Council could provide affordable housing in a newly created Local Housing Company (LHC). In time, the Council could apply to the Regulator to have the LHC registered as a Registered Provider of Social Housing which would give it the opportunity to apply for grant from Homes England.

The Council would need to clarify whether it would be possible for a non-RP company to acquire s106 affordable homes according to its local planning and housing policies.

The LHC option gives more flexibility around provision as there would be no regulatory restrictions on rents; this could provide for diversified affordable housing offers e.g. Key Workers, intermediate rents, bespoke shared ownership schemes, rent to buy schemes etc; these are not applicable in the HRA.

The LHC would be a separate entity, with a separate board, governance and accounting arrangements. A board of directors would need to be appointed and a Managing Director designated to operate the company (which in all probability would be a seconded officer from the Council).

The LHC would be funded by the Council providing loans into the company; these would be at a higher rate than the HRA and suggest that rents would need to be higher in the company.

As rents would still be below market, State Aid considerations do not apply to the LHC (compared, for example, to the Council's existing market renting company). However, the Council would still want to lend at a premium in order to cover the greater risks of operating a separate company.

Tenants of the company would be on Assured Shorthold Tenancies as they would be in the private sector, albeit at "affordable" sub-market rents.

In the short term, the LHC would need to engage a third party to provide housing management and repairs services; this could be a partner RP. In time, and depending on scale, the LHC may be able to develop its own in house services.

There are tax (VAT and Corporation Tax) implications within the LHC option – these would be offset by the opportunity to raise a premium return on lending to the Council.

The creation of an affordable company could draw on the experience that the Council has had in already setting up a subsidiary company to provide housing.

5. Provision of affordable housing within Aspects

In theory, the Council could extend the provision of housing by Aspects to include affordable housing. This could have the advantage of the governance arrangements already being in place and thereby result in lower set up costs compared to a new standalone company.

In many respects, the features and factors associated with running a LHC apply to this route: greater flexibility, returns to the Council via the financing mechanism, tax implications, asset trading etc.

There are however potential complexities in respect of State Aid and financing. Affordable housing would not be viable at the commercial borrowing rates that apply to market housing; there would therefore need to be two separate lending approaches. State Aid compliance could be affected by the need to demonstrate separation between the two sides of the business. Management arrangements would also need to be different for the affordable housing provision. The board might require a different skills mix.

6. Registration of a company as a RP

There are a number of authorities that have moved to register an affordable housing company as an RP; the process is very procedural and is currently taking up to 15 months. Our sense is that this option is being pursued in addition to HRA provision in order to combine the flexibility of a company with the ability to bring in grant from Homes England, and in some cases to avoid the Right to Buy.

The position on registration for a merged market and affordable housing company is likely to be more complex. The Regulator has encouraged a clear separation of "market" from "social/affordable" housing activities in recent years and an application for registration would in effect be from a private provider seeking to provide a new stream of affordable housing. It is almost certain that the Regulator would require a separate entity to register.

7. Financial modelling

Our initial assessment of the financial model of acquiring and then providing 800+ affordable homes within the One Horton Heath development is that the Council should be able to develop a viable and sustainable business plan for either the HRA or a company.

The potential to achieve this level of scale in the medium term should provide additional reassurance around the financial viability of an HRA.

The local housing company model is financially viable but, compared to the HRA, is subject to higher costs and some tax leakage, which could be offset by a premium return on lending for the Council. Rents would therefore almost certainly have to be set higher than in the HRA.

8. Proposed approach

It is understood that the Council has an ambition to provide social and affordable housing directly, and at some scale.

Subject to committing to a significant pipeline of development and acquisition, which has a realistic trajectory above 200 homes in the short-medium term (3-5 years), the suggested way forward would be to acquire housing under Part II of the Housing Act 1985 and reopen the HRA from the outset.

There are no barriers to this approach. The HRA now is able to draw on financial flexibilities that are materially different to when the Council originally closed its HRA in the 1990s.

This approach would:

- Recognise both the ambitions of, and direction of travel within, the Council
- Allow the cheapest funding, minimal additional governance and the opportunity to share costs between the General Fund and HRA
- Avoid the need to apply for waiver to hold in the General Fund in the short-term
- Avoid the need to split the finances between General Fund and HRA if the HRA was not reopened from the outset
- Gain some protection from Right to Buy into the medium term
- Also allow the Council to provide temporary accommodation from the HRA on a temporary basis if required.

Communication with, and an application to, MHCLG to reopen the HRA is likely to be a formality.

The HRA could commence separate accounting from any period, however a 1st April start would seem sensible, linked to the first year that expenditure on HRA assets would be incurred. We understand this could be 2021.22.

The Council would reopen the HRA in the full knowledge of the constraints and restrictions on its operation, principally rents, asset disposal and the nature of the tenancies, and that these can managed appropriately.

Should the Council wish to also make provision of non-Social Housing, non-s106 but still sub-market housing, an affordable local housing company could operate alongside a reopened HRA; the Council might therefore keep this option under review, particularly as it already has experience of setting up and operating a subsidiary housing company.

Enclosed

Annex 1: detailed report and financial analysis